BEFORE THE ARIZONA CORPORATION

COMMISSIONERS

GARY PIERCE, Chairman
BOB STUMP
SANDRA D. KENNEDY
PAUL NEWMAN
BRENDA BURNS

E-01345A-11-0423

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR AN ORDER OR ORDERS AUTHORIZING IT TO ISSUE, INCUR, AND AMEND EVIDENCES OF LONG-TERM INDEBTEDNESS, SHORT-TERM INDEBTEDNESS, AND OTHER LONG-TERM SECURITIES, TO MANAGE INTEREST RATE RISK, TO EXECUTE NEW SECURITY INSTRUMENTS TO SECURE ANY SUCH INDEBTEDNESS OR OTHER LONG-TERM SECURITIES, AND FOR DECLARATORY ORDER CONCERNING VARIABLE INTEREST ENTITIES	DOCKET NO. E-01345A-11-____ **APPLICATION**

I. INTRODUCTION

Pursuant to Sections 40-285, 40-301, and 40-302 of the Arizona Revised Statutes ("A.R.S."), and the Arizona Corporation Commission's ("Commission") Decision No. 69947 (October 30, 2007) (the "2007 Order"), Arizona Public Service Company ("APS" or "Company") hereby files this Application ("Application") seeking one or more orders which, together, will authorize the Company to: (i) incur the Continuing Long-Term Debt (as defined herein) or Other Long-Term Securities (as defined herein); (ii) continue its authorization of Continuing Short-Term Debt granted in the 2007 Order, including the ability to redeem, refinance, refund, renew, reissue, roll-over, repay, re-price and re-borrow from time to time such Continuing Short-Term Debt, and establish and amend the terms and provisions of Continuing Short-Term Debt from time to time; (iii) redeem, refinance, refund, renew, reissue, roll-over, repay, re-price and re-borrow from time to time such Continuing Long-Term Debt and Other Long-Term Securities, and establish and amend the terms and provisions of Continuing Long-

Term Debt and Other Long-Term Securities from time to time; (iv) manage interest rate risk and exposure associated with Continuing Long-Term Debt, Other Long-Term Securities, and Continuing Short-Term Debt, as the Company deems appropriate based, among other things, on market conditions from time to time; and (v) determine the form of security, if any, for the Continuing Long-Term Debt, Other Long-Term Securities, and the Continuing Short-Term Debt; execute and deliver one or more Security Instruments (as defined herein) in connection with the Continuing Long-Term Debt, Other Long-Term Securities, and the Continuing Short-Term Debt; and establish and amend the terms and provisions of any such Security Instruments from time to time.

APS further requests a declaratory order confirming that all impacts of the consolidation with APS for accounting purposes of the Palo Verde Sale Leaseback Lessor Trusts as Variable Interest Entities ("VIEs") are to be excluded for the purpose of calculating Common Equity Test and DSC (both as defined in the 2007 Order). VIEs should also be excluded from calculating any dollar limits for the authorizations of Continuing Long-Term Debt, Other Long-Term Securities, and Continuing Short-Term Debt.

APS requests issuance of the order or orders sought in this Application no later than December 31, 2012 so that APS will have sufficient financing authority to support its current and anticipated financing needs without interruption, and to permit APS to manage its capital structure appropriately under changing market conditions. APS also requests that the order or orders sought in this Application become effective immediately upon the issuance thereof.

II. SUPPORTING STATEMENTS

In support of this Application, the Company respectfully states as follows:

1. APS is a corporation duly organized and existing under the laws of the State of Arizona. The Company's principal place of business is 400 North Fifth Street, Phoenix, Arizona, 85004, and its post office address is P.O. Box 53999, Phoenix, Arizona 85072-3999.

2. The Company is a public service corporation principally engaged in serving electricity in the State of Arizona.

3. The Company is a wholly owned subsidiary of Pinnacle West Capital Corporation ("Pinnacle West").

4. On October 19, 2011, the Company's Board of Directors approved the filing of this Application with the Commission.

5. The attorneys for the Company in this proceeding are Meghan H. Grabel and Thomas L. Mumaw.

6. This Application is supported by the Affidavit of Lee R. Nickloy, the Vice President and Treasurer of the Company (the "Affidavit"), which is attached hereto as Exhibit A.

A. Financing Needs and Issues.

7. The 2007 Order allows the Company, among other things, to (i) issue, sell, and incur the Continuing Long-Term Debt (defined as long-term indebtedness (including current maturities) outstanding on the effective date of the 2007 Order or thereafter issued or incurred pursuant to the 2007 Order) as long as the total Continuing Long-Term Debt does not exceed $4.2 billion for any period of more than thirty days; (ii) issue, sell, and incur Continuing Short-Term Debt (defined as all short-term indebtedness outstanding on the effective date of the 2007 Order or thereafter issued or incurred pursuant to the 2007 Order) as long as the total Continuing Short-Term Debt does not exceed the sum of (a) seven percent (7%) of the Company's capitalization, and (b) $500 million; (iii) redeem, refinance, refund, renew, reissue, roll-over, repay, and re-borrow from time to time such Continuing Long-Term Debt and Continuing Short-Term Debt; (iv) establish and amend the terms and provisions of the Continuing Long-Term Debt and Continuing Short-Term Debt; (v) determine the form of security, if any, for the Continuing Long-Term Debt and Continuing Short-Term Debt, execute and deliver any necessary Security Instruments (defined as any mortgage and deed of trust or similar instrument that establishes a lien on (a) all or substantially all of the

Company's property, including after-acquired property, as security for all or any part of the Company's indebtedness, or (b) separate properties or groups of properties of the Company to secure particular issues or groups of issues of indebtedness), and establish and amend the terms and provisions of the Security Instruments, as may be deemed appropriate by the Company; (vi) to pay all related expenses; and (vii) to reimburse Pinnacle West for any reasonable amounts paid by Pinnacle West under any guarantee of the Company's debt. In addition, the 2007 Order allowed Pinnacle West to guarantee the Company's indebtedness from time to time in indeterminate amounts.[1] A copy of the 2007 Order is attached to this Application as Exhibit B.

8. In this Application, the Company requests Commission authorization to increase the long-term indebtedness limitation set forth in the 2007 Order and to allow for other types of securities providing long-term capital financing, including, without limitation, preferred stock, trust preferred securities (potentially issued through an affiliated trust created for such purpose), or other forms of so-called "hybrid" capital securities (collectively referred to herein as "Other Long-Term Securities").[2] Under the requested authorization, the Company would be permitted to have outstanding at any one time from the date of such authorization and thereafter up to an aggregate principal amount of Continuing Long-Term Debt and Other Long-Term Securities of $5.5 billion.[3] (All long-term indebtedness (including current maturities) outstanding on the date of the order or orders of the Commission in this matter or thereafter issued or incurred pursuant to this paragraph being herein referred to as "Continuing Long-Term Debt"). For purposes of such limit, any security issued to support, or otherwise issued in connection with, such Other Long-Term Security would not also be counted in order

[1] Such guarantees are no longer needed by APS given the respective financial situations and ratings of Pinnacle West and APS. Thus, Pinnacle West has not joined in this Application and this aspect of the 2007 Order will lapse upon the issuance of an Order in this Docket.

[2] "Hybrid" securities have attributes of both debt and equity securities, and are difficult to easily classify as being one or the other form of long-term financing.

[3] As noted herein, this $5.5 billion limit would exclude debt incurred by VIEs and consolidated with APS by VIEs under GAAP or lease obligations resulting from the Palo Verde Unit 2 Sale/Leaseback, which has been separately authorized by the Commission in Decision Nos. 55120 (July 24, 1986) and 55320 (December 5, 1986).

to avoid duplication with the Other Long-Term Security which is counted against the limit. The Affidavit describes the Company's reasons for its request for additional financing authority, and the basis of the requested increase. *See* discussion of "APS's Long-Term Financing Needs" in the Affidavit attached as Exhibit A. The Company requests that such authorization permit any redemptions, refinancings, refundings, renewals, reissuances, roll-overs, repayments, re-pricings and re-borrowings of any such Continuing Long-Term Debt or Other Long-Term Securities, the incurrence or issuance of any additional Continuing Long-Term Debt or Other Long-Term Securities, and the establishment, amendment, or revision of any terms or provisions of or relating to any Continuing Long-Term Debt or Other Long-Term Securities, as long as the sum of Continuing Long-Term Debt and Other Long-Term Securities, without duplication, at any one time outstanding does not exceed $5.5 billion for any period of more than thirty days. Such authorization will allow the Company to maintain its flexibility to refund and/or incur or issue Continuing Long-Term Debt and Other Long-Term Securities as market conditions dictate. At no time, however, will the Company be able to exceed the proposed Continuing Long-Term Debt and Other Long-Term Securities limitation for any period of more than thirty days without further Commission authorization. The authorization sought in this paragraph would supersede the Continuing Long-Term Debt limitation authorized by the 2007 Order.

9. The Company also requests Commission authorization to manage interest rate risks and exposure associated with any long-term or short-term indebtedness authorized herein, as the Company deems appropriate based, among other things, on market conditions from time to time, by executing and entering into instruments such as fixed-to-floating interest rate swaps, floating-to-fixed interest rate swaps, Treasury rate locks, interest rate caps, and forward starting swaps. Such authorization will allow the Company to limit ratepayers' exposure to interest rate volatility and/or potentially achieve lower interest rates. The Company requests any gains or losses associated with pre-issuance interest rate hedging transactions be treated similarly to debt reacquisitions

and be amortized over the life of the new debt issuance to which they relate. Any fixed-to-floating or floating-to-fixed interest rate transactions or interest rate caps would be reflected in the net interest rate of the financing instruments to which those transactions relate.

10. The Company also requests a declaratory order that confirms that all impacts of the consolidation with APS for accounting purposes of the Palo Verde Sale Leaseback Lessor Trusts (VIEs) are to be excluded for the purpose of calculating the Common Equity Test and DSC (both as defined in the 2007 Order) and any Continuing Long-Term Debt, Other Long-Term Securities, and Continuing Short-Term Debt limitations as proposed herein. Although beginning in 2010, GAAP required these entities to be consolidated with APS for financial reporting purposes, APS has no debt or equity interest in the VIEs and does not exercise any manner of control over them.

11. With regard to Other Long-Term Securities, they should be treated for purposes of the Common Equity Test and the DSC in accordance with the way they are treated by at least one of the major credit rating agencies. For example, if a rating agency considered a form of Other Long-Term Security to be 50% debt and 50% equity (and the periodic payments related to such security to be half interest and half dividend or other equity return), this same ratio would be used in the Common Equity Test and the DSC.

12. The Company requests that the authorizations sought in this Application terminate on December 31st of the fifth calendar year from the effective date of the order or orders issued in this proceeding.

13. The Company requests that all other ordering language, provisions, obligations, and requirements of the 2007 Order as they apply to APS, without any modification in substance except as expressly requested herein, be included in the Order or Orders sought in this Application.

B. Purposes.

14. The Company proposes that the net proceeds from its issuance of Continuing Long-Term Debt, Other Long-Term Securities, and Continuing Short-Term Debt will be applied, directly or indirectly, to augment the funds available from all sources to finance its construction, resource acquisition and maintenance programs, to redeem or retire outstanding securities, to repay or refund other outstanding long-term or short-term debt, and to meet certain of the Company's working capital and other cash requirements.

C. General.

15. In the Company's opinion, the proposed issuance or incurrence of the Continuing Long-Term Debt, Other Long-Term Securities, and the Continuing Short-Term Debt, the establishment and amendment of any terms and provisions of any long-term or short-term indebtedness, the execution and delivery of the Security Instruments, and the establishment and amendment of any terms and provisions of the Security Instruments, all as contemplated herein, are for lawful purposes that are within its corporate powers and are compatible with the public interest, with sound financial practices, and with the proper performance by the Company of service as a public service corporation and will not impair its ability to perform that service. The Company is further of the opinion that the foregoing, all as contemplated herein, are reasonably necessary or appropriate for such purposes and that such purposes are not, wholly or in part, reasonably chargeable to the Company's operating expenses or to income.

16. The Company requests that notice of the filing of this Application be given in conformity with A.R.S. Section 40-302.

17. The Company requests that the order or orders sought by this Application become effective immediately upon the issuance thereof.

18. The most current public financial statements of the Company and Pinnacle West, which are included in their most recent combined Quarterly Report on

Form 10-Q filed with the Securities Exchange Commission, are attached to this Application as Exhibit C.

WHEREFORE, the Company asks that the Commission cause notice of the filing of this Application to be given as requested above; hold such a hearing or hearings as the Commission deems necessary at a time or times to be specified, make any inquiry or investigation as the Commission may deem of assistance in this matter; and make any findings required by A.R.S. Sections 40-285, 40-301, and 40-302, as applicable, relative to the issuance and incurrence of Continuing Long-Term Debt, Other Long-Term Securities, and Continuing Short-Term Debt, management of interest rate risk and exposure associated with Continuing Long-Term Debt, Other Long-Term Securities, and Continuing Short-Term Debt, the execution and delivery of the Security Instruments, the establishment and amendment of any terms and provisions of any Continuing Long-Term Debt, Other Long-Term Securities, or Continuing Short-Term Debt or any such Security Instruments issued in accordance therewith; and thereafter make one or more immediately effective orders which, together, (i) increase the sum of the Continuing Long-Term Debt and Other Long-Term Securities limit from $4.2 billion to $5.5 billion; (ii) authorize the Company to manage interest rate risk and exposure associated with Continuing Long-Term Debt, Other Long-Term Securities, and Continuing Short-Term Debt; (iii) confirm that impacts of consolidation of Palo Verde Sale Leaseback Lessor Trusts are to be excluded from the Common Equity Test and DSC calculations as well as the limits on Continuing Long-Term Debt, Other Long-Term Securities, and Continuing Short-Term Debt; (iv) direct that the impact of Other Long-Term Securities on the Common Equity Test and the DSC will be as set forth herein; (v) confirm that authorizations sought in this Application will terminate on December 31st of the fifth calendar year following the effective date of order or orders sought in this Application; and (vi) confirm that all ordering language, provisions, obligations, and requirements of the 2007 Order not modified by the clauses (i), (ii), (iii) (iv) and (v) above will be included in the order or orders sought in this Application.

Dated at Phoenix, Arizona this 22nd day of November, 2011.

ARIZONA PUBLIC SERVICE COMPANY

By: ______________________________
Lee R. Nickloy
Vice President and Treasurer

By: ______________________________
Thomas L. Mumaw
Meghan H. Grabel
Pinnacle West Capital Corporation Law Department

ATTORNEYS FOR ARIZONA PUBLIC SERVICE COMPANY

EXHIBITS

Exhibit A	Affidavit of Lee R. Nickloy, the Vice President and Treasurer of APS.
Exhibit B	Arizona Corporation Commission Order in Decision No. 69947 (October 30, 2007).
Exhibit C	Pinnacle West Capital Corporation and Arizona Public Service Company Quarterly Report on Form 10-Q for the quarter ended September 30, 2011.

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

GARY PIERCE, Chairman
BOB STUMP
SANDRA KENNEDY
PAUL NEWMAN
BRENDA BURNS

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR AN ORDER OR ORDERS AUTHORIZING IT TO ISSUE, INCUR, AND AMEND EVIDENCES OF LONG-TERM INDEBTEDNESS, SHORT-TERM INDEBTEDNESS, AND OTHER LONG-TERM SECURITIES, TO MANAGE INTEREST RATE RISK, TO EXECUTE NEW SECURITY INSTRUMENTS TO SECURE ANY SUCH INDEBTEDNESS OR OTHER LONG-TERM SECURITIES, AND FOR DECLARATORY ORDER CONCERNING VARIABLE INTEREST ENTITIES	DOCKET NO. E-01345A-11-______ **AFFIDAVIT OF LEE R. NICKLOY**

STATE OF ARIZONA)
) ss.
County of Maricopa)

I, Lee R. Nickloy, upon my oath, do swear and attest as follows:

General

1. My name is Lee R. Nickloy. I am Vice President and Treasurer for Arizona Public Service Company ("APS" or "Company"). I am responsible for the Treasury functions at APS.

2. The assertions of fact contained within the Application of the Company to which this Affidavit is attached are true and correct to my knowledge and belief.

3. The purpose of this Affidavit is to testify, from my personal experience and involvement as the Treasurer, regarding the rationale behind the requests contained in the Application.

Specific Background Facts

4. Arizona Corporation Commission ("Commission") Decision No. 69947 (October 30, 2007) (the "2007 Order"), allows the Company to have outstanding at any one time long-term indebtedness (including current maturities) in an aggregate principal amount of $4.2 billion. By its terms, the 2007 Order excludes the impact of the Palo Verde Unit II sale/leaseback transaction, which was separately approved by the Commission in Decision Nos. 55120 (July 24, 1986) and 55320 (December 5. 1986). The 2007 Order permits the Company to issue, redeem or refinance and establish and amend the terms of its long-term debt, as long as total outstanding long-term debt does not exceed $4.2 billion during any period of more than thirty days. The fact that the long-term debt limit can actually be exceeded for a period of thirty days or less enables APS to continue its ability to conservatively refinance in advance of an upcoming maturity or planned redemption if APS is at or near the total limitation.

5. The new financing authority requested in the Application would enable APS to continue to manage its financing requirements consistent with, or despite, as the case may be, changing financial needs, conditions and costs of capital. On a macro level, the capital markets remain uncertain given the sovereign debt crisis in Europe and domestic fiscal and monetary, concerns and these issues will not be solved in the near-term. These issues will likely continue to weigh on investor sentiment and risk appetite for several years. Related to these factors is volatility in costs of capital, principally benchmark US Treasury interest rates, which has a direct impact on the Company's financing costs. At the Company level, significant capital investment including renewable generation additions, compliance with new environmental regulations, and

continued investment in energy delivery infrastructure to maintain and upgrade existing facilities to maintain performance and reliability standards and meet the future needs of our customers will need to be made and requires the Company to be able to efficiently and reliably access external capital needed to support those investments. Thus, the requested financing order is compatible with sound financial policy and the public interest.

6. Arizona Revised Statutes §40-302.D allows the Company to issue short-term debt in an amount not to exceed 7% of its capitalization without Commission approval. However, §40-302.D restricts the refunding or roll-over of any such notes. The 2007 Order allows the Company to refund or roll-over any such short-term debt as long as the total short-term debt does not exceed the sum of (A) 7% of the Company's capitalization and (B) $500 million. APS seeks no change to that authorization.

7. The Company is asking the Commission to increase the Continuing Long-Term Debt limit, including the issuance of preferred stock, trust preferred securities (potentially issued through an affiliated trust created for such purpose) or other forms of so-called "hybrid" securities described hereinafter as "Other Long-Term Securities," to $5.5 billion.

Benefits of Financial Flexibility

8. The concept of an overall dollar limit on the amount of long-term debt outstanding, as contained in the 2007 Order, provides financial flexibility that allows APS to access the capital markets when timely, limit exposure to distress and disruptions in the capital markets and avoid over-reliance on short-term borrowing and liquidity resources. This flexibility occurs in a number of areas, and a few examples are listed here. First, there is the ability to time the financing around SEC disclosure filings and cash flow requirements. Markets are volatile, and having the ability to quickly enter the markets to issue new debt and other securities yields better financing pricing and terms

and reduces risk. Second, there is the ability to size the issuance at a more optimal level. For example, over the last 25 or so years (the time during which APS has been bound only by a dollar limit), APS knew it could enter the market as many times as necessary as long as it stayed within the limit, so it was able to do smaller debt issuances that were advantageous at the time. Third, there is the ability to obtain the best terms available at the time. Because the Company was given the ability to negotiate the terms deemed appropriate, it could adapt to changing market conditions and get the best terms available at the time of the financing.

9. The 2007 Order granted APS authorization to enter into a new mortgage or other security agreements, and the Company asks that this same authorization be continued. Such authorization included the ability of APS to pledge or mortgage APS assets as security for its debt. APS redeemed the last of its secured debt in April of 2004. Prior to that time, APS had issued debt that was secured by substantially all of APS's property pursuant to a 1946 Mortgage and Deed of Trust. The 1946 Mortgage was almost 60 years old at the time of termination and it did not reflect current market standards for utility secured bond indentures. It also contained certain restrictive covenants. By eliminating the 1946 Mortgage, APS has greater financial flexibility. However, there may come a time when it is advantageous for APS to enter into a new mortgage or other security agreements and once again issue secured debt.

10. As described earlier, and as further illustrated later in this Affidavit and in Appendix A, the new financing authority requested in the Application would enable APS to continue to manage its financing requirements and capital structure despite changing financial needs and conditions. Thus, the requested financing order is compatible with sound financial policy and the public interest.

11. The Company has continuously complied with each of the terms and conditions of the 2007 Order and is in compliance with such Order as of the date of this Application.

APS's Long-Term Debt Financing Needs

12. In light of the continuing and growing need of the Company to invest in utility infrastructure and both new and existing generation resources, and the resulting projected future financing needed to fund the Company's capital expenditures, maintenance program and other cash requirements, the Company requests Commission authorization to increase the long-term debt limitation (and expand the type of securities the Company may issue – the "Other Long-Term Securities" – as described below, and also inclusive within this limitation) by $1.3 billion so that the Company may have up to an aggregate principal amount of such outstanding securities of $5.5 billion. This amount would include the $4.2 billion of long-term debt securities currently authorized in the 2007 Order. *See* Appendix A to my Affidavit for details on the derivation of the total $5.5 billion of long-term debt and Other Long-Term Securities authority requested. Absent this higher continuing limit, APS's ability to fund these requirements and access the capital markets in a timely manner and to take advantage of favorable market conditions and limit risk will be severely impacted. APS would be required to request Commission authorization for each debt issuance once the current limit is met and would need to seek authorization well in advance of each issuance to ensure the authorization was in place at the time the funding was required. In addition to hampering the Company's ability to strategically access the capital markets, which could unnecessarily increase the Company's cost of capital, this would be administratively inefficient for both the Commission and the Company.

13. Appendix A illustrates and supports the Company's request for the $5.5 billion overall limit for outstanding long-term indebtedness and Other Long-Term

Securities – effectively incorporating a total estimate of future external financing required after giving effect to internally generated cash and the infusion of common equity capital into APS by its parent company, Pinnacle West Capital Corporation. The schedule provides long-term debt balances (which would also include Other Long-Term Securities for purposes of this analysis) at the beginning and ending of each year for a five-year period beginning at the end of 2012. Using a forecast assuming the Company's cash flows continue based on its existing rate structure, the Company's operating cash flows are shown ("funds from operations") along with use of those cash flows to make capital investment and support dividends. Funds from operations include the Company's net earnings adjusted for non-cash items such as depreciation and deferred taxes. The net result of these sources and uses of cash is negative, thus implying a need for external financing. These external financing requirements are addressed in part by additional common equity, and the remainder with long-term financing of the type requested in the instant application. Based on these assumptions, total outstanding long-term debt (and Other Long-Term Securities) reaches $5.5 billion by 2017.

Other Components of Requested Authorization

A. Interest Rate Management

14. From time to time, in order to reduce interest rate risk related to an upcoming planned debt issuance and/or economically "convert" an existing fixed rate financing obligation to floating rate or vice versa to achieve lower cost financing or protect against interest rate volatility, it may be advantageous for the Company to enter into interest rate management or hedging instruments. The new financing authorization requested by the Company includes authority for various forms of such instruments which specifically address these needs and which can effectively manage interest rate risk related to changes in U.S. Treasury yields and credit spreads, cap or limit interest rates paid by the Company, or provide for the ability to take advantage of lower short-term

interest rates which provides another tool to capture short-term interest rate exposure for a long-term debt obligation.

B. Other Long-Term Securities

15. For purposes of financing its long-term capital needs, the Company currently only has the ability to issue long-term debt securities and generate equity capital through ongoing earnings and equity infusions from its parent company. These two forms of capital represent the two ends of the capital security continuum. These two forms of capital can be contrasted by their relative after-tax cost of capital (debt being the cheapest), supportiveness of stronger credit ratings (equity driving higher credit ratings), sources of capital including investor base, tenor or maturity, along with other characteristics and attributes. The Company finances its permanent assets through a mix of capital, and the more sources of such capital it is able to employ, the more effectively it can manage its capital structure to achieve a reasonable weighted average cost of capital, achieve ratings objectives, maintain a diverse investor base and maintain ready, reliable access to capital.

Adding the ability to issue these other forms of capital ("Other Long-Term Securities") including preferred stock, trust preferred securities (through an affiliated trust created for that purpose) and other forms of hybrid securities with characteristics of both debt and equity and achieving some amount of equity content or treatment from the rating agencies can help achieve these objectives and can play an important and beneficial role in the Company's capital structure.

Summary

16. The financing flexibility provided in previous Commission orders has served the Company's customers extremely well by allowing the Company to access frequently volatile capital markets in a timely and efficient manner, thereby enhancing the Company's ability to finance its capital needs, enabling it to appropriately fund its

debt maturity requirements and potentially reducing the Company's financing costs and the cost of capital reflected in customer rates. APS faces increasing and significant capital expenditures that will necessitate additional long-term financing. The Company is seeking a new financing order that continues the authorization of the issuance of Continuing Long-Term Debt and newly authorizes the issuance of Other Long-Term Securities (subject, in the aggregate, to a higher overall cap of $5.5 billion) and manage interest rate risk and exposure. This new financing order would allow APS to continue to meet growing financing needs in an efficient and cost effective manner that benefits APS's customers.

Dated this 21st day of November, 2011.

FURTHER AFFIANT SAYETH NOT.

Lee R. Nickloy

SUBSCRIBED AND SWORN TO BEFORE ME this 21st day of November, 2011, by Lee R. Nickloy, Vice President and Treasurer of Arizona Public Service Company.

Notary Public

MY COMMISSION EXPIRES: Feb 27, 2015

Sherry Elizabeth Price
NOTARY PUBLIC - ARIZONA
MARICOPA COUNTY
My Commission Expires
February 27, 2015

Projected APS Outstanding Long-Term Debt
($MM)

	2011	2012	2013	2014	2015	2016	2017
Long-term debt at beginning of year		$3,281	$3,424	$3,700	$4,065	$4,672	$5,097
Funds from operations		$1,020	$957	$978	$1,027	$934	$934
Capital expenditures		($1,176)	($1,181)	($1,080)	($1,370)	($1,095)	($1,095)
Dividends		($237)	($252)	($263)	($264)	($264)	($264)
Free cash flow		($393)	($476)	($365)	($607)	($425)	($425)
= External financing need		$393	$476	$365	$607	$425	$425
External financing financed with equity		($250)	($200)				
Long-term debt at end of year	$3,281	$3,424	$3,700	$4,065	$4,672	$5,097	$5,522

Exhibit B

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

Arizona Corporation Commission
DOCKETED
OCT 30 2007
DOCKETED BY ne

MIKE GLEASON - Chairman
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
KRISTIN K. MAYES
GARY PIERCE

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR AN ORDER OR ORDERS AUTHORIZING IT TO ISSUE, INCUR, AND AMEND EVIDENCES OF LONG-TERM INDEBTEDNESS AND SHORT-TERM INDEBTEDNESS, TO EXECUTE NEW SECURITY INSTRUMENTS TO SECURE ANY SUCH INDEBTEDNESS, TO REPAY AMOUNTS PAID UNDER ANY PINNACLE WEST CAPITAL CORPORATION GUARANTEE OF ARIZONA PUBLIC SERVICE COMPANY INDEBTEDNESS AND FOR DECLARATORY ORDER.	DOCKET NO. E-01345A-06-0779
IN THE MATTER OF THE APPLICATION OF PINNACLE WEST CAPITAL CORPORATION FOR AN ORDER OR ORDERS AUTHORIZING IT TO GUARANTEE THE INDEBTEDNESS OF ARIZONA PUBLIC SERVICE COMPANY.	DECISION NO. **69947** **OPINION AND ORDER**

DATE OF HEARING:	July 23, 2007
PLACE OF HEARING:	Phoenix, Arizona
ADMINISTRATIVE LAW JUDGE:	Lyn Farmer
IN ATTENDANCE:	Mike Gleason, Chairman Kristin K. Mayes, Commissioner
APPEARANCES:	Mr. Thomas L. Mumaw and Ms. Meghan Grable, on behalf of Arizona Public Service Company; and Ms. Janet Wagner, Senior Counsel, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission.

BY THE COMMISSION:

On December 15, 2006, Arizona Public Service Company ("APS" or "Company") filed a verified application with the Arizona Corporation Commission ("Commission") for authorization to: 1) incur the Continuing Long-Term Debt; 2) redeem, refinance, refund, renew, reissue, roll-over, repay and re-borrow from time to time such Continuing Long-Term Debt, and establish and amend the terms and provisions of Continuing Long-Term Debt from time to time; 3) incur the Continuing Short-Term Debt; 4) redeem, refinance, refund, renew, reissue, roll-over, repay, and re-borrow from time to time such Continuing Short-Term Debt, and establish and amend the terms and provisions of Continuing Short-Term Debt from time to time; 5) determine the form of security, if any, for the Continuing Long-Term Debt and the Continuing Short-Term Debt, execute and deliver one or more Security Instruments in connection with the Continuing Long-Term Debt and the Continuing Short-Term Debt, and establish and amend the terms and provisions of any such Security Instruments from time to time; and 6) reimburse any amounts paid by Pinnacle West Capital Corporation ("PWCC") under any Guarantee. PWCC also filed an application (together, "Joint Application") pursuant to A.A.C. R14-2-806 requesting an ongoing waiver or authorization under A.A.C. R14-2-803 for PWCC to guarantee the indebtedness of APS from time to time. APS further requested a declaratory order that confirms that only traditional indebtedness for borrowed money constitutes an "evidence of indebtedness" under A.R.S. §§ 40-301 and 40-302 and that such other arrangements do not require prior Commission authorization and do not count against the Continuing Long-Term Debt or Continuing Short-Term debt authorizations requested in the application.

On January 11, 2007, APS and PWCC filed a letter waiving the requirements of A.A.C. R14-2-806's thirty day "time clock" for ruling on requests for waivers of the Commission's affiliate rules.

On March 6, 2007, APS and PWCC filed a Notice of Publication.

On May 18, 2007, the Commission's Utilities Division ("Staff") filed its Staff Report. In its report, Staff recommended conditional approval of the various financing transactions and denial of the request for a declaratory order.

On May 29, 2007, APS and PWCC filed their comments to the Staff Report.

On June 22, 2007, a Procedural Order was issued setting the matter for hearing.

On July 18, 2007, Staff filed the testimony of Gordon L. Fox, and APS filed its list of witnesses and exhibits.

The hearing was held as scheduled on July 23, 2007. Ms. Barbara Gomez, Vice President and Treasurer of APS and PWCC, testified on behalf of APS, and Mr. Gordon Fox, Financial Analyst

Manager, testified on behalf of Staff. No members of the public appeared to make public comment.

On August 1, 2007, APS filed its late-filed exhibits Nos. 4 and 5.[1]

* * * * * * * * * *

Having considered the entire record herein and being fully advised in the premises, the Commission finds, concludes, and orders that:

FINDINGS OF FACT

1. APS is a public service corporation principally engaged in furnishing electricity in the State of Arizona. APS provides either retail or wholesale electric service to substantially all of Arizona, with the major exceptions of the Tucson metropolitan area and about one-half of the Phoenix metropolitan area. APS also generates, sells and delivers electricity to wholesale customers in the western United States.

2. On December 15, 2006, APS and PWCC filed the Joint Application.

3. Notice of the Application was published in the *Arizona Republic* on February 24, 2007. Notice of the hearing was published in the *Arizona Republic* on June 30, 2007 in accordance with the June 22, 2007, Procedural Order.

4. The hearing commenced on July 23, 2007 and testimony and evidence was presented by APS and Staff.

Long-Term and Short-Term Debt

5. APS currently has financing authority pursuant to Decision No. 55017 (May 6, 1986) which allows the Company to have long-term indebtedness (including current maturities) in an aggregate principal amount of up to \$2,698,917,000[2] and pursuant to Decision No. 65796 (April 4, 2003) which authorized APS to issue \$500 million of long-term debt and to loan the proceeds to PWCC or Pinnacle West Energy Corporation ("PWEC"), its merchant subsidiary, to finance the

[1] Exhibit No. 4 is in response to Commissioner Mayes' request for additional detail regard the construction expenditure projections contained in the APS response to Staff's Data Requests, as reflected in Staff Exhibit No. 1. Exhibit No. 5 is an update of the proposed ordering language contained in Exhibit F to APS Exhibit No. 2.

[2] Decision No. 55017 also allows redemptions, refinancings, refundings, renewals, reissuances, and roll-overs of outstanding debt, the incurrence or issuance of long-term debt and the amendment or revision of any terms or provisions of or relating to any long-term debt, as long as the total long-term debt at any one time outstanding does not exceed \$2,698,917,000 during any period of more than 30 days.

construction of PWEC's electric generating plants.[3] The total current authorized long-term debt limit is $3,198,917,000.

6. The Joint Application requests authorization to increase the long-term indebtedness limitation set forth in Decision No. 55017 so that APS may have, at any one time outstanding, up to an aggregate principal amount of long-term indebtedness of $4.2 billion, including the $500 million authorized in Decision No. 65796. APS also requests that, similar to Decision No. 55107, the authorization permit any redemptions, refinancings, refundings, renewals, reissuances, roll-overs, repayments, and re-borrowings of such outstanding indebtedness, the incurrence or issuance of any additional long-term indebtedness, and the establishment, amendment, or revision of any terms or provisions of or relating to any long-term indebtedness, as long as total long-term indebtedness (including current maturities thereof) at any one time outstanding does not exceed $4.2 billion for any period of more than 30 days.[4] This authorization would supersede the long-term indebtedness limitation authorized by Decision No. 55017 and would include the debt authorized by Decision No. 65796.

7. A.R.S. § 40-302(D) allows APS to issue short-term debt in an amount not to exceed seven percent (7%) of its capitalization without Commission approval, but restricts the refunding or roll-over of any such notes. Decision No. 54230 (November 8, 1984) allows APS to reissue, renew, and resell any such short-term indebtedness with or into additional short-term indebtedness, as long as the seven percent limit is not exceeded.

8. APS witness Gomez testified that as APS continues to grow, so does its need for working capital. As APS' load has grown, APS has an increased exposure to contracted commodity and purchased power which have collateral provisions that can result in significant liquidity demands as market prices change. This increased liquidity required to respond to volatile and increasing collateral requirements has caused the need for short-term debt in excess of the currently authorized amount. According to witness Gomez, the Company recently completed an assessment of its

[3] Decision No. 65796 specified that the $500 million financing would not be classified or treated as continuing debt in the context of the debt limits contained in Decision No. 55017.

[4] Allowing the long-term debt limit to be exceeded for a period of thirty days or less enables APS to issue new long-term debt in advance of an upcoming planned redemption. APS Exhibit 1, Affidavit of Barbara M. Gomez, Vice President and Treasurer of APS and PWCC.

liquidity needs and determined that an additional $500 million short-term debt authorization was necessary.[5]

9. In the Joint Application, APS requests Commission authorization to issue short-term debt at any time and from time to time (excluding current maturities of long-term debt) in an amount not to exceed the sum of: (i) seven percent (7%) of the Company's capitalization and (ii) $500 million. APS requests that such authorization permit any redemptions, refinancings, refundings, renewals, reissuances, roll-overs, repayments, and re-borrowings of any such outstanding indebtedness, the incurrence or issuance of any additional short-term indebtedness, and the establishment, amendment, or revision of any terms or provision of or relating to any short-term indebtedness, as long as total short-term indebtedness at any one time outstanding (excluding current maturities of long-term debt) does not exceed, for a period of more than thirty (30) days, the sum of: (i) seven percent (7%) of the Company's capitalization and (ii) $500 million without further Commission authorization.

10. APS proposes to determine the nature of the Continuing Long-Term Debt and Continuing Short-Term Debt, the maturities, the interest and/or discount rates, the necessity for and form of any security, the applicable financial markets (e.g., whether domestic or foreign) or lenders, the nature (e.g., whether public or private) of the offerings or borrowings, and the type or types of transaction in which debt would be sold or incurred, by reference to the conditions in the financial markets at the time(s) of commitment or sale. According to APS, the terms would be negotiated with the intent of obtaining the most favorable results for the Company and its customers.

11. APS proposes that the net proceeds from its issuances of Continuing Long-Term Debt and Continuing Short-Term Debt will be applied, directly or indirectly, to augment the funds available to finance its construction, resource acquisition and maintenance programs, to redeem or retire outstanding securities, to repay or refund other outstanding long-term or short-term debt, and to meet certain of the Company's working capital and other cash requirements.

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[5] This estimate includes $250 million for normal working capital requirements; $350 million for additional collateral needed if the price of gas moved by 33 percent; and $110 million for collateral contracts and $175 million for prepaid fuel requirements if APS were to become non-investment grade. These items provided the basis for the requested additional $500 million. TR pp 27-28, 113-115.

12. According to the Joint Application, APS believes that the proposed issuance or incurrence of the Continuing Long-Term Debt and the Continuing Short-Term Debt, the establishment and amendment of any terms and provisions of long-term or short-term indebtedness, the execution and delivery of security instruments, and the establishment and amendment of any terms and provision of the security instruments are for lawful purposes that are within its corporate powers and are compatible with the public interest, with sound financial practices, and with the proper performance by the Company as a public service corporation and will not impair its ability to perform that service; and that further, they are reasonably necessary or appropriate for such purposes and that such purposes are not, wholly or in part, reasonably chargeable to the Company's operating expenses or to income, except to the extent required by generally accepted accounting principles or by other accounting requirements applicable to the Company, including regulatory requirements. To the extent that the purposes may be considered reasonably chargeable to operating expenses or to income, APS requests that the Commission authorize such charge(s).

13. Staff provided testimony based upon its financial review and analysis and included an engineering analysis and review in its filed Staff Report. Staff's witness testified that there are two overriding considerations that the Commission should use in making its determination whether or not to grant the authorizations. The first is whether a company has the technical and financial expertise to make decisions on an ongoing basis under a general authorization as requested in the Joint Application, or whether a company should be required to apply for specific authorizations on a case-by-case basis. Staff noted that under a general authorization a company has more flexibility and when used properly, it can provide many benefits to not only a company, but also to its ratepayers.[6] Staff concluded that APS has the technical and financial expertise to operate under a general authority, citing APS' healthy capital structure, its history of prompt rate cases and emergency rate cases, and its requests for recovery of under-collections of the adjustor mechanism. Staff also noted APS' demonstrated ability to use its financial flexibility to benefit and lower its capital costs, and indicated that the Company also needs that flexibility to manage its operating cash needs well.

[6] TR p. 177.

Secondly, Staff recommended that the Commission should consider the integrity of the management of the Company. Staff points out these considerations because unless the Commission believes the Company meets them, adding conditions such as equity ratios or modified debt service ratios may ultimately do little to protect the Company's ratepayers.

14. According to the Engineering Staff Report, Staff reviewed APS' anticipated load and customer growth, customer reliability statistics, and the 2007-2011 Construction Work Plans and concluded that:

1. The load and customer growth rates of APS are reasonably projected based on past load and customer growth rates and overall population growth expected for Arizona.
2. The customer reliability measures for the last five years on an aggregate system basis indicate APS is managing its distribution system on a comparable par with the better performing utilities in the nation with regard to reliability. APS is in a good position to continue this trend with continued emphasis on reliability and appropriate infrastructure investment.
3. APS is making investment in its capital plant over the next five years in a manner that indicates new customers will be adequately and timely served and all customers can expect a reasonable level of reliability. APS' Five Year Construction Work Plan is appropriate and associated cost estimates are reasonable. However, this does not imply a specific treatment or recommendation for rate base or rate making purposes in APS' future rate filings.
4. Staff finds that APS' growth, reliability and capital investment plans are integrally related and dependent on access to capital.[7]

15. APS filed its late-filed APS Exhibit No. 4, which included the detailed project-by-project description and projected cash flows for 2007 to 2011 for nuclear, fossil, transmission, distribution, and general plant.

16. Staff's financial review and analysis of the Joint Application indicated that an increase in APS' long-term debt to $4.2 billion would create a capital structure of 43.3 percent equity and 56.7 percent long-term debt.[8]

17. Staff analyzed the financial effects of the requested authorizations and concluded, with Staff's modifications, that the request is within APS' corporate powers, is compatible with the public interest, would not impair APS' ability to provide service and would be consistent with sound

[7] Staff Exhibit No. 1, Staff Report, Attachment A p. 6.

[8] Approval of the Joint Application will not eliminate the 40 percent common equity test for issuance of dividends as required in Decision No. 65796 (April 4, 2003) TR p. 68.

financial practices if after the debt issuance, the conditions recommended by Staff are met.

18. Staff recommended increasing the long-term debt threshold to $4.2 billion subject to the following conditions: (1) common equity divided by common equity and long-term debt (including current maturities) is 40 percent or greater using the most recent audited financial statements adjusted to reflect changes to outstanding debt; and (2) the debt service coverage ratio ("DSC") as modified to exclude principal debt repayments ("Modified DSC"), must be equal to or greater than 2.0.

19. Staff recommended authorization for APS to incur short-term debt in an amount not to exceed $500 million above seven percent (7%) of total capital provided that "(1) the excess over 7 percent of total capital shall be used solely for costs relating to natural gas or power purchases and (2) APS has an authorized adjustor mechanism for recovery of these kinds of costs."[9] Staff also recommended that if APS' adjustor mechanism is terminated, "the short-term debt authorizations granted should continue for an additional twelve months."[10] This would allow APS to address its short-term debt balances. Currently, the short-term limit of seven percent of capitalization is approximately $425 million, and with the additional $500 million, the total short-term debt authorization would be $925 million.

20. Staff recommended that the authorizations to incur short-term and long-term debt obligations should replace all existing authorizations to incur new short-term and long-term debt obligations, and that all existing authorizations to incur new short-term and long-term debt obligations should terminate upon the effective date of this Decision, and that all existing obligations remain valid. Staff testified that this recommendation does not affect the authorizations related to the Palo Verde sale/leaseback transactions/obligations contained in Decision Nos. 55120 and 55320.[11]

21. In its initial Staff Report, Staff also recommended that the "short-term and long-term debt levels authorized in this proceeding terminate on December 31, 2012."[12] In response to APS' comments, Staff agreed that only authorizations of new debt should terminate at December 31, 2012,

[9] Staff Exhibit No. 2, Fox Direct Testimony, p. 12.
[10] Ibid.
[11] TR pp. 155-156, 171, 174-175.
[12] Staff Exhibit No. 1, Staff Report, p. 6.

and that existing obligations at that date should remain valid. In its Comments, APS requested that the December 31, 2012 termination date be extended until the Commission issues a new financing order replacing the then-existing order, provided that "(a) APS files an application for a new financing order on or before December 31, 2011 and (b) the Commission has not issued an order pursuant to such application on or before December 31, 2012."[13] According to APS, this will "ensure that APS' ability to access the capital markets is not abruptly terminated, which would prohibit APS from funding its ongoing operations and meeting its obligations as a public service corporation."[14] Staff agreed with APS' suggestion as it pertains to short-term authorizations due to the immediate needs to fund natural gas and power acquisitions, but disagreed as applied to long-term debt. Staff noted that "the needs for long-term debt are of a different nature and have greater long-term effects."[15] Because the Company could file a request for a specific debt issuance, instead of raising the general threshold, Staff recommends that the Commission not prematurely assess the circumstances that may exist in the future, but instead reserve its decision until the circumstances at that time can be evaluated. We agree with this recommendation of Staff. Although the authorizations to issue new long-term debt pursuant to this Decision will expire, APS has the ability to ask for specific financing approval for any necessary purpose, and knowing the expiration date will allow it to plan accordingly.

22. APS requested that to the extent that the purposes of the debt may be considered reasonably chargeable to operating expenses or to income, APS be authorized to issue such debt. A.R.S. § 40-302 specifically provides that before a public service corporation issues notes and other evidences of indebtedness, it must first secure an order from the Commission stating "the purposes to which the issue or proceeds thereof are to be applied, and that, in the opinion of the commission, the issue is reasonably necessary or appropriate for the purposes specified in the order, pursuant to section 40-301, and that, except as otherwise permitted in the order, **such purposes are not, wholly or in part, reasonably chargeable to operative expenses or to income**." (emphasis added) APS did not offer any explanation of why it needed to issue debt that would be chargeable to operating

[13] APS Exhibit No. 2, APS Comments, p. 9.
[14] Ibid.
[15] Staff Exhibit No. 2, Fox Direct Testimony, p. 9.

expenses or to income, except to say that the purposes for which it plans to use the debt may be required by Generally Accepted Accounting Principles ("GAAP") or "other accounting requirements applicable to the Company" to be charged to operating expenses or income. This is not an explanation, but just recognition that the "purpose" has been found to be chargeable to operating expense or income.

23. The ordering language proposed by APS in its late-filed Exhibit 5 (" . . . and to meet certain of the Company's working capital and other cash requirements. Such purposes are within those permitted by A.R.S. Section 40-301 and are permitted regardless of the extent to which they may be reasonably chargeable to operating expenses or to income.") is very broad and does not specify why a statutory exception should apply for those purposes. Apparently, allowing APS this exception would enable it to use cash proceeds from Continuing Long-Term Debt to pay its on-going operating expenses and to pay dividends. We decline to adopt such a "blanket exception" to this statutory language in a general financing authorization. While there may be purposes that would justify authorizing APS to use Continuing Long-Term Debt to pay operating expenses or to charge it to income, those purposes should be evaluated either by classification or as they occur on an individual basis.

24. Staff recommends that when APS enters into a single agreement/transaction or an aggregate of similar agreements/transactions or an amendment(s) to an existing agreement(s) with a single entity in which APS incurs long-term debt exceeding $5,000,000 within a calendar year, that APS should file with Docket Control within 90 days of the transaction or aggregation of transactions of at least $5,000,000, a description of the transaction(s) and a demonstration that the rates and terms were consistent with those generally available to comparable entities at the time. Staff's recommendation is reasonable and we will adopt it.

25. We find that with the appropriate conditions and safeguards adopted in this Decision, it is appropriate to increase APS' authorized debt limits for short-term and long-term debt as set forth herein.

Declaratory Order

26. APS further requested a declaratory order that confirms that only traditional

indebtedness for borrowed money constitutes an "evidence of indebtedness" under A.R.S. §§ 40-301 and 40-302 and that such other arrangements do not require prior Commission authorization and do not count against the Continuing Long-Term Debt or Continuing Short-Term Debt authorizations requested in the application.

27. Staff recommended denial of APS' request for a declaratory order in its initial Staff Report. According to the Staff Report, APS currently has two agreements that are classified as long-term debt per GAAP. APS wants to exclude those agreements from treatment as debt. Staff believes that incurring excessive debt is a concern, regardless of the form the debt takes, and that a declaratory order would exempt certain financing activities from appropriate controls established by the long-term debt limitations established by the Commission. Staff believes that the point is to identify debt as debt,[16] and if the Company needs additional authorizations, it should seek them.

28. APS witness Gomez testified that as a result of changes in accounting principles and interpretations, there could be instances where other types of financial obligations could be classified as debt in the Company's financial statements in order to comply with GAAP. Examples include long-term power purchase agreements, which, depending upon the length and nature of the agreement, may be classified as capital leases and reflected as debt on the balance sheet; and long-term fuel supply contracts. Ms. Gomez testified that these could potentially erode the debt-issuing capability of APS and greatly affect the ability of APS to plan its normal financing activities.

29. In its Comments, APS suggested the following additional provisions to "avoid unintended and patently unfair consequences" if APS were to exceed its authorized debt limits solely as a result of future changes in GAAP or future changes in the interpretation of GAAP (collectively, "GAAP change"):

a) Any contract or other legally-binding arrangement to which APS was a party as of the date of the Commission's order in this matter (the "Existing Obligations"), will not be considered indebtedness for purposes of the order (including the order's debt limitations, common equity test, and debt service coverage test) if the Existing Obligation was not considered indebtedness under GAAP as of such date;
b) If a GAAP change subsequently occurs that results in an Existing Obligation being

[16] GAAP status is the determinant for compliance filings and how the condition test for issuance of debt or equity is calculated. TR p. 190.

reclassified as indebtedness, APS will notify the Commission of such GAAP Change within 30 days after APS files its Quarterly Report on Form 10-Q or its Annual Report on Form 10-K with the Securities and Exchange Commission following the end of the fiscal quarter in which such GAAP Change occurs (the "Notification Period");

c) If, after the Commission's issuance of an order in this matter, APS enters into a contract or binding arrangement that is not considered indebtedness under GAAP but subsequently is considered indebtedness because of a GAAP Change, APS' obligations under such contract or arrangement will not be considered indebtedness for purposes of this order (including the order's debt limitations, common equity test, and debt service coverage test) until further Commission action, if within the Notification Period, APS files an application with the Commission specifically requesting approval of such reclassified debt obligations.[17]

30. In response, Staff agreed that future changes in GAAP could have unintended consequences as they pertain to the Staff conditions, and making provisions to avoid such unintended consequences is prudent. Staff had no objection to: establishment of a "Notification Period" consistent with APS' proposal; and exempting from debt, for purposes of applying the conditions for issuances of debt, (1) existing legally-binding arrangements that are not considered indebtedness under GAAP as of the effective date of this Decision and (2) future legally-binding arrangements that are not considered indebtedness under GAAP on their effective dates but that subsequently become indebtedness under GAAP due to changes in GAAP, until further Commission action if APS files an application within the Notification Period that specifically requests a decision regarding whether to include or exclude the obligation(s) that are subject to the GAAP change in calculations for purposes of applying the conditions for issuance of debt that are established in this Decision.[18]

31. We agree with Staff that APS' request for a declaratory order should be denied. The purpose of long-term debt limits would be frustrated if APS could structure the form of its debt to avoid those limits. However, while we disagree that a declaratory order is necessary or appropriate at this time, we agree with APS that future changes in GAAP or its interpretation may have unintended collateral effects on APS' ability to issue debt pursuant to this order. We find that APS' alternative proposal, as agreed to by Staff, that establishes a process where an application can be filed with the Commission during the notification period, allowing the Commission to make a determination whether the "now GAAP" arrangements/obligations should fall under the limits and conditions of this

[17] APS Exhibit No. 2, Comments pp. 7-8.
[18] Staff Exhibit No. 2, Fox Direct, p. 6; TR pp. 162-166.

Decision, is a good solution and will adopt it.

Mortgage/Security Interests

32. APS redeemed the last of its secured debt in April, 2004. Prior to then, APS had issued debt that was secured by substantially all of the property of APS, pursuant to its 1946 Mortgage and Deed of Trust. According to APS, the 1946 Mortgage did not reflect current market standards for utility secured bond indentures and contained restrictive covenants, so by eliminating it, APS has had greater financial flexibility. APS witness Gomez testified that there may come a time when it is advantageous for APS to enter into a new mortgage or other security agreements and once again issue secured debt. The security could consist of a mortgage or lien, or a letter of credit of a third party, bond purchase agreement, or other security instrument. Therefore, APS is requesting authorization to enter into a new mortgage and deed of trust that establishes a lien on all or substantially all of the Company's property, including after-acquired property, and authority to enter into separate security instruments for one or more particular debt issuances.

33. Staff recommended that the Commission grant authorization for APS to (1) conduct the activities enumerated in the application that are necessary to secure and maintain debt; (2) to determine the form of security, if any, for the continuing long-term debt and the continuing short-term debt, execute and deliver the security instruments, and establish and amend the terms and provisions of the security instruments, as may be deemed appropriate by APS in connection with the long-term debt and the short-term debt; and (3) to pay all related expenses, all as contemplated in the application and by the exhibits and testimony.

34. We agree with APS and Staff that APS should have the flexibility to enter into a new mortgage or other security agreements and once again issue secured debt. However, we find that APS should make an informational filing as a compliance filing in this docket when and if it enters into a new mortgage and deed of trust.

PWCC Guarantee

35. APS witness Gomez testified that from time to time, it may be advantageous for

PWCC to guarantee debt issued, incurred or sold by APS.[19] The Joint Application requests either an ongoing waiver of A.A.C. R14-2-803[20] or alternatively, that the Commission expressly grant to PWCC the authority to guarantee APS' debt from time to time in indeterminate amounts. APS seeks authorization to reimburse PWCC for any amounts that PWCC is required to pay under any such guarantee, along with interest until the date of reimbursement, at a rate not greater that the rate of interest payable on the debt guaranteed and paid by PWCC. According to the Joint Application, the purpose of any guarantees by PWCC would be to allow APS to achieve greater access to the financial markets.

36. Staff recommended denial of PWCC's request for a waiver of A.A.C. R14-3-803 but recommended authorization for PWCC to guarantee APS' debt from time to time in indeterminate amounts. Staff also recommended authorization for APS to reimburse PWCC for debt service costs paid by PWCC on behalf of APS in conjunction with the provision of guarantees of APS debt and a cost of money on those payments not to exceed that of the underlying loan(s).

37. We agree with Staff that a blanket waiver of A.A.C. R14-2-803 is not appropriate, but that allowing PWCC to guarantee APS' debt in order for APS to access debt on more favorable terms would benefit APS ratepayers. We find that APS should be authorized to reimburse PWCC for reasonable debt service costs, together with the cost of money on those payments at a rate not to exceed that of the underlying loan(s). APS should make an informational filing as a compliance filing in this docket when and if PWCC guarantees APS debt.

CONCLUSIONS OF LAW

1. Arizona Public Service Company is a public service corporation within the meaning of Article XV of the Arizona Constitution and A.R.S. §§ 40-285, 40-301, and 40-302 and A.A.C. R-14-2-804.

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[19] If APS were to be rated non-investment grade by at least one rating agency, the new Securities and Exchange rules require a parent guarantee in order for APS to use the expedited rules that allow it easier access to the capital markets. TR, pp. 34, 70-76. PWCC does not intend to guarantee APS debt unless APS is downgraded. TR p.76.

[20] A.A.C. R14-2-803 requires notice to the Commission of reorganizations by a public utility holding company such as PWCC and includes the acquisition or divestiture of a financial interest in an affiliate or a Class A utility such as APS, as limited by Commission Decision No. 58063 (November 3, 1992) to increases or decreases to existing financial interests in excess of a specified exempt amount (now $150 million for APS and PWCC, TR p. 91).

2. The Commission has jurisdiction over Arizona Public Service Company and the subject matter of the application.

3. Notice of the application and hearing were provided in accordance with the law.

4. The Joint Application should be approved consistent with the Discussion, Analysis, and Findings of Fact herein.

5. The financing with the conditions approved herein is for lawful purposes within Arizona Public Service Company's corporate powers, is compatible with the public interest, with sound financial practices, and with the proper performance by Arizona Public Service Company of service as a public service corporation, and with the conditions approved herein, will not impair Arizona Public Service Company's ability to perform that service.

6. The financing with the conditions approved herein is for the purposes stated in the application and is reasonably necessary for those purposes and such purposes, other than those relating to the issuance or incurrence of Continuing Short-Term Debt, are not, wholly or in part, reasonably chargeable to operating expenses or to income.

7. The financing with the conditions approved herein will not impair the financial status of the public utility, otherwise prevent it from attracting capital at fair and reasonable terms, or impair the ability of the public utility to provide safe, reasonable and adequate service.

ORDER

IT IS THEREFORE ORDERED that Arizona Public Service Company is hereby authorized (i) to issue, sell, and incur the Continuing Long-Term Debt (defined as all long-term indebtedness (including current maturities) outstanding on the effective date of this Decision or thereafter issued or incurred pursuant to this Decision, not to exceed $4.2 billion for any period of more than thirty days) and the Continuing Short-Term Debt, as such term is defined below, redeem, refinance, refund, renew, reissue, roll-over, repay, and re-borrow from time to time such Continuing Long-Term Debt and Continuing Short-Term Debt, and establish and amend the terms and provisions of long-term and short-term indebtedness from time to time, (ii) to determine the form of security, if any, for the Continuing Long-Term Debt and the Continuing Short-Term Debt, execute and deliver the Security

Instruments, and establish and amend the terms and provisions of the Security Instruments, as may be deemed appropriate by Arizona Public Service Company in connection with the Continuing Long-Term Debt and the Continuing Short-Term Debt, and (iii) to pay all related expenses, all as contemplated in the Application and by the exhibits and testimony presented during the hearing in this matter.

IT IS FURTHER ORDERED that Arizona Public Service Company is authorized to issue short-term debt at any time and from time to time (excluding current maturities of long-term debt) in an amount not to exceed seven percent (7%) of Arizona Public Service Company's capitalization plus up to an additional $500 million. The amount of the short-term debt issued in excess of seven percent (7%) of Arizona Public Service Company's capitalization shall be used for purchases of natural gas and power. (All short-term indebtedness outstanding on the date of this Order or hereafter issued or incurred pursuant to this paragraph is referred to as "Continuing Short-Term Debt.")

IT IS FURTHER ORDERED that prior to the issuance or incurrence of short-term debt in excess of seven percent (7%) of Arizona Public Service Company's capitalization (up to $500 million relating to purchases of natural gas and power), Arizona Public Service Company must have a Commission authorized adjustor mechanism for recovery of natural gas or power purchases and, if such mechanism is terminated, the authorization for the additional $500 million of short-term debt will terminate 12 months thereafter.

IT IS FURTHER ORDERED that if all or a portion of the authorized short-term debt relating to natural gas and power purchases becomes classified as long-term debt because the amount remains outstanding for more than 12 months, such debt will continue to be counted as Continuing Short-Term Debt and should not be counted against the Continuing Long-Term Debt limit.

IT IS FURTHER ORDERED that immediately subsequent to the issuance of any Continuing Long-Term Debt:

(a) Arizona Public Service Company must have a minimum common equity ratio of forty percent (40%) (the "Common Equity Test"). For purposes of this test, the common equity ratio is calculated as common equity divided by the sum of such common equity and Arizona Public Service Company's long-term debt (including current maturities of long-term debt). The Common Equity Test will be calculated using the most recent audited financial statements available prior to the date of calculation, adjusted to give effect to the issuance of any new indebtedness (including the proposed indebtedness for which the calculation is being made).

(b) Arizona Public Service Company's debt service coverage ratio ("DSC") must be equal to or greater than 2.0. For purposes of this test, the DSC is calculated as operating income plus depreciation and amortization plus income tax, divided by interest on short-term and long-term debt, using the most recent audited financial statements adjusted to reflect the interest impact of changes to outstanding debt to the date of calculation, calculated as the annualized interest at the actual interest rate on any new debt issued after the 12 month period covered by the applicable audited financial statements and remaining outstanding on the date of calculation and further including, for purposes of this calculation, the annualized interest at the expected interest rate on the new long-term debt to be issued or incurred and for which the DSC calculation is being made.

IT IS FURTHER ORDERED that changes in United States generally accepted accounting principles ("GAAP") or changes in the interpretation of GAAP (collectively, "GAAP Changes") shall be treated as follows: any contract or other legally-binding arrangement to which Arizona Public Service Company is or becomes a party (each, an "Obligation") will not be considered indebtedness for purposes of this Order, including the Continuing Long-Term Debt limit, the Continuing Short-Term Debt limit, the Common Equity Test, and the DSC, until further Commission action, if (a) the Obligation was not considered indebtedness under GAAP as of the date Arizona Public Service Company became a party to the Obligation; (b) a GAAP Change subsequently occurs that results in the Obligation being considered indebtedness for purposes of GAAP; (c) Arizona Public Service Company notifies the Commission of the GAAP Change that results in the Obligation being classified as indebtedness for GAAP purposes within 30 days after Arizona Public Service Company files its Quarterly Report on Form 10-Q or its Annual Report on Form 10-K with the Securities and Exchange Commission following the end of the fiscal quarter in which such GAAP Change occurs (the "Notification Period"); and (d) within the Notification Period, Arizona Public Service Company files an application with the Commission specifically requesting a decision regarding whether such reclassified Obligation should be included in, or excluded from, the Continuing Long-Term Debt limit, the Continuing Short-Term Debt limit, the Common Equity Test, and the DSC calculation.

IT IS FURTHER ORDERED that the authorizations to incur short-term and long-term debt obligations provided in this Order shall replace all existing authorizations for the incurrence of short-term and long-term debt, and all such existing authorizations shall terminate upon the effective date of this Order. Notwithstanding the above, the Commission's Decision No. 55120 (July 24, 1986) and Decision No. 55320 (December 5, 1986) (the "Sale-Leaseback Authorizations") will remain in full force and effect.

IT IS FURTHER ORDERED that the short-term and long-term debt levels authorized in this Order will terminate on December 31, 2012, provided that all short-term and long-term debt outstanding at December 31, 2012 that was previously authorized pursuant to the Order shall remain authorized and valid obligations of Arizona Public Service Company. The December 31, 2012 termination date will be extended for Continuing Short-Term Debt until the Commission issues a new financing order replacing the then-existing order, provided that (a) Arizona Public Service Company files an application for a new financing order on or before December 31, 2011 and (b) the Commission has not issued an order pursuant to such application on or before December 31, 2012.

IT IS FURTHER ORDERED that on each occasion when Arizona Public Service Company enters into a new long-term debt agreement, Arizona Public Service Company must file with Docket Control as a compliance item in this docket, a description of the transaction and a demonstration that the rates and terms are consistent with those generally available to comparable entities at the time. No such filing need be made for any such new long-term debt agreement that has a principal value of less than $5 million within a calendar year for (a) any individual agreement or transaction or (b) the aggregate of similar agreements or transactions with a single entity.

IT IS FURTHER ORDERED that in the event that Arizona Public Service Company enters into a new mortgage and deed of trust, Arizona Public Service Company shall file documentation with Docket Control as a compliance filing in this docket within 60 days of entering into the mortgage or deed of trust.

IT IS FURTHER ORDERED that Arizona Public Service Company is hereby authorized to sign and deliver such documents and to engage in such acts as are reasonably necessary to effectuate the authorizations granted hereinabove.

IT IS FURTHER ORDERED that the purposes for which the proposed issuances of Continuing Long-Term Debt and the Continuing Short-Term Debt are herein authorized are to augment the funds available from all sources to finance Arizona Public Service Company's construction, resource acquisition and maintenance programs, to redeem or retire outstanding securities, to repay or refund other outstanding long-term or short-term debt and to use Continuing Short-Term Debt to meet certain of Arizona Public Service Company's working capital and other cash requirements and such purposes, other than those relating to the issuance or incurrence of Continuing Short-Term Debt, are not, wholly or in part, reasonably chargeable to operating expense or to income.

IT IS FURTHER ORDERED that Pinnacle West Capital Corporation is hereby authorized under A.A.C. R14-2-803 to guarantee Arizona Public Service Company's indebtedness from time to time in indeterminate amounts. Arizona Public Service Company is hereby authorized to reimburse Pinnacle West Capital Corporation for any reasonable amounts paid by Pinnacle West Capital Corporation under any guarantee of Arizona Public Service Company's debt from time to time, along with interest thereon to the date of reimbursement at a rate of interest not greater than the rate payable on the debt so guaranteed and paid by Pinnacle West Capital Corporation.

IT IS FURTHER ORDERED that in the event that Pinnacle West Capital Corporation guarantees debt of Arizona Public Service Company, Arizona Public Service shall file documentation with Docket Control as a compliance filing in this docket within 60 days of the guarantee.

IT IS FURTHER ORDERED that Arizona Public Service Company shall use the proceeds from debt incurred pursuant to this authorization only for the purposes set forth herein.

IT IS FURTHER ORDERED that approval of the financing set forth herein does not constitute or imply approval or disapproval by the Commission of any particular expenditure of the proceeds derived thereby for purposes of establishing just and reasonable rates.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN COMMISSIONER

COMMISSIONER COMMISSIONER COMMISSIONER

IN WITNESS WHEREOF, I, DEAN S. MILLER, Interim Executive Director of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 30th day of Oct., 2007.

DEAN S. MILLER
INTERIM EXECUTIVE DIRECTOR

DISSENT ____________________

DISSENT ____________________

SERVICE LIST FOR: ARIZONA PUBLIC SERVICE COMPANY

DOCKET NO.: E-01345A-06-0779

Thomas L. Mumaw
Barbara M. Gomez
ARIZONA PUBLIC SERVICE CO.
PINNACLE WEST CAPITAL CORP.
400 N. 5th Street, Mail Station 8695
Phoenix, AZ 85004-3992

Christopher Kempley, Chief Counsel
Legal Division
ARIZONA CORPORATION COMMISSION
1200 W. Washington Street
Phoenix, Arizona 85007

Ernest Johnson, Director
Utilities Division
ARIZONA CORPORATION COMMISSION
1200 W. Washington Street
Phoenix, Arizona 85007

Exhibit C

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)
☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2011

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ______ to ______

Commission File Number	Exact Name of Each Registrant as specified in its charter; State of Incorporation; Address; and Telephone Number	IRS Employer Identification No.
1-8962	**PINNACLE WEST CAPITAL CORPORATION** (an Arizona corporation) 400 North Fifth Street, P.O. Box 53999 Phoenix, Arizona 85072-3999 (602) 250-1000	86-0512431
1-4473	**ARIZONA PUBLIC SERVICE COMPANY** (an Arizona corporation) 400 North Fifth Street, P.O. Box 53999 Phoenix, Arizona 85072-3999 (602) 250-1000	86-0011170

Indicate by check mark whether each registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
PINNACLE WEST CAPITAL CORPORATION Yes X No __
ARIZONA PUBLIC SERVICE COMPANY Yes X No __

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
PINNACLE WEST CAPITAL CORPORATION Yes X No __
ARIZONA PUBLIC SERVICE COMPANY Yes X No __

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.
PINNACLE WEST CAPITAL CORPORATION
Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☐
ARIZONA PUBLIC SERVICE COMPANY
Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☒ Smaller reporting company ☐

Indicate by check mark whether each registrant is a shell company (as defined in Exchange Act Rule 12b-2).
PINNACLE WEST CAPITAL CORPORATION Yes __ No X
ARIZONA PUBLIC SERVICE COMPANY Yes __ No X

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date.

PINNACLE WEST CAPITAL CORPORATION	Number of shares of common stock, no par value, outstanding as of October 25, 2011: 109,181,233
ARIZONA PUBLIC SERVICE COMPANY	Number of shares of common stock, $2.50 par value, outstanding as of October 25, 2011: 71,264,947

Arizona Public Service Company meets the conditions set forth in General Instruction H(1)(a) and (b) of Form 10-Q and is therefore filing this form with the reduced disclosure format allowed under that General Instruction.

TABLE OF CONTENTS

This combined Form 10-Q is separately provided by Pinnacle West Capital Corporation ("Pinnacle West") and Arizona Public Service Company ("APS"). Any use of the words "Company," "we," and "our" refer to Pinnacle West. Each registrant is providing on its own behalf all of the information contained in this Form 10-Q that relates to such registrant and, where required, its subsidiaries. Except as stated in the preceding sentence, neither registrant is providing any information that does not relate to such registrant, and therefore makes no representation as to any such information. The information required with respect to each company is set forth within the applicable items. Item 1 of this report includes Condensed Consolidated Financial Statements of Pinnacle West and Condensed Consolidated Financial Statements of APS. Item 1 also includes Notes to Pinnacle West's Condensed Consolidated Financial Statements, the majority of which also relate to APS, and Supplemental Notes, which only relate to APS's Condensed Consolidated Financial Statements.

FORWARD-LOOKING STATEMENTS

This document contains forward-looking statements based on current expectations. These forward-looking statements are often identified by words such as "estimate," "predict," "may," "believe," "plan," "expect," "require," "intend," "assume" and similar words. Because actual results may differ materially from expectations, we caution readers not to place undue reliance on these statements. A number of factors could cause future results to differ materially from historical results, or from outcomes currently expected or sought by Pinnacle West or APS. In addition to the Risk Factors described in Part I, Item 1A of the Pinnacle West/APS Annual Report on Form 10-K for the fiscal year ended December 31, 2010 ("2010 Form 10-K"), in Part II, Item 1A of the Pinnacle West/APS Quarterly Report on Form 10-Q for the quarter ended June 30, 2011 (the "Second Quarter 10-Q"), in Part II, Item 1A of this Report and in Part I, Item 2 – "Management's Discussion and Analysis of Financial Condition and Results of Operations," these factors include, but are not limited to:

- our ability to achieve timely and adequate rate recovery of our costs, including returns on debt and equity capital;
- our ability to manage capital expenditures and other costs while maintaining reliability and customer service levels;
- variations in demand for electricity, including those due to weather, the general economy, customer and sales growth (or decline), and the effects of energy conservation measures and distributed generation;
- power plant and transmission system performance and outages;
- volatile fuel and purchased power costs;
- fuel and water supply availability;
- regulatory and judicial decisions, developments and proceedings;
- new legislation or regulation, including those relating to environmental requirements and nuclear plant operations;
- our ability to meet renewable energy and energy efficiency mandates and recover related costs;
- risks inherent in the operation of nuclear facilities, including spent fuel disposal uncertainty;
- competition in retail and wholesale power markets;
- the duration and severity of the economic decline in Arizona and current real estate market conditions;
- the cost of debt and equity capital and the ability to access capital markets when required;
- changes to our credit ratings;
- the investment performance of the assets of our nuclear decommissioning trust, pension, and other postretirement benefit plans and the resulting impact on future funding requirements;
- the liquidity of wholesale power markets and the use of derivative contracts in our business;
- potential shortfalls in insurance coverage;
- new accounting requirements or new interpretations of existing requirements;
- generation, transmission and distribution facility and system conditions and operating costs;
- the ability to meet the anticipated future need for additional baseload generation and associated transmission facilities in our region;
- the willingness or ability of our counterparties, power plant participants and power plant land owners to meet contractual or other obligations or extend the rights for continued power plant operations;
- technological developments affecting the electric industry; and
- restrictions on dividends or other provisions in our credit agreements and Arizona Corporation Commission ("ACC") orders.

These and other factors are discussed in Risk Factors described in Part I, Item 1A of our 2010 Form 10-K, in Part II, Item 1A of our Second Quarter 10-Q and in Part II, Item 1A of this Report, which readers should review carefully before placing any reliance on our financial statements or disclosures. Neither Pinnacle West nor APS assumes any obligation to update these statements, even if our internal estimates change, except as required by law.

PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PINNACLE WEST CAPITAL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(unaudited)
(dollars and shares in thousands, except per share amounts)

	Three Months Ended September 30, 2011	2010
OPERATING REVENUES		
Regulated electricity	$ 1,124,049	$ 1,116,211
Other revenues	792	499
Total	1,124,841	1,116,710
OPERATING EXPENSES		
Regulated electricity fuel and purchased power	337,896	353,904
Operations and maintenance	210,035	219,658
Depreciation and amortization	106,350	104,177
Taxes other than income taxes	34,223	37,528
Other expenses	1,320	1,169
Total	689,824	716,436
OPERATING INCOME	435,017	400,274
OTHER INCOME (DEDUCTIONS)		
Allowance for equity funds used during construction	7,378	5,524
Other income (Note 11)	441	4,261
Other expense (Note 11)	(3,052)	(3,894)
Total	4,767	5,891
INTEREST EXPENSE		
Interest charges	62,034	60,419
Allowance for borrowed funds used during construction	(6,939)	(6,163)
Total	55,095	54,256
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	384,689	351,909
INCOME TAXES	131,416	122,347
INCOME FROM CONTINUING OPERATIONS	253,273	229,562
INCOME FROM DISCONTINUED OPERATIONS		
Net of income tax expense of $6,216 and $5,859 (Note 13)	9,512	9,477
NET INCOME	262,785	239,039
Less: Net income attributable to noncontrolling interests (Note 7)	7,426	5,119
NET INCOME ATTRIBUTABLE TO COMMON SHAREHOLDERS	$ 255,359	$ 233,920
WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING – BASIC	109,128	108,632
WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING – DILUTED	109,861	109,094
EARNINGS PER WEIGHTED-AVERAGE COMMON SHARE OUTSTANDING		
Income from continuing operations attributable to common shareholders – basic	$ 2.25	$ 2.07
Net income attributable to common shareholders – basic	2.34	2.15
Income from continuing operations attributable to common shareholders – diluted	2.24	2.06
Net income attributable to common shareholders – diluted	2.32	2.14
DIVIDENDS DECLARED PER SHARE	$ --	$ --
AMOUNTS ATTRIBUTABLE TO COMMON SHAREHOLDERS:		
Income from continuing operations, net of tax	$ 245,838	$ 224,434
Discontinued operations, net of tax	9,521	9,486
Net income attributable to common shareholders	$ 255,359	$ 233,920

See Notes to Pinnacle West's Condensed Consolidated Financial Statements.

PINNACLE WEST CAPITAL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(unaudited)
(dollars and shares in thousands, except per share amounts)

	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
OPERATING REVENUES		
Regulated electricity	$ 2,570,692	$ 2,527,052
Other revenues	2,795	4,715
Total	2,573,487	2,531,767
OPERATING EXPENSES		
Regulated electricity fuel and purchased power	793,952	821,244
Operations and maintenance	675,654	639,580
Depreciation and amortization	319,550	307,806
Taxes other than income taxes	112,002	100,933
Other expenses	4,536	3,572
Total	1,905,694	1,873,135
OPERATING INCOME	667,793	658,632
OTHER INCOME (DEDUCTIONS)		
Allowance for equity funds used during construction	18,697	16,417
Other income (Note 11)	2,630	3,851
Other expense (Note 11)	(7,921)	(8,768)
Total	13,406	11,500
INTEREST EXPENSE		
Interest charges	183,251	181,937
Allowance for borrowed funds used during construction	(14,371)	(12,254)
Total	168,880	169,683
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	512,319	500,449
INCOME TAXES	176,229	165,882
INCOME FROM CONTINUING OPERATIONS	336,090	334,567
INCOME FROM DISCONTINUED OPERATIONS		
Net of income tax expense of $7,121 and $14,873 (Note 13)	10,860	23,141
NET INCOME	346,950	357,708
Less: Net income attributable to noncontrolling interests (Note 7)	20,041	15,005
NET INCOME ATTRIBUTABLE TO COMMON SHAREHOLDERS	$ 326,909	$ 342,703
WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING – BASIC	109,003	105,846
WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING – DILUTED	109,683	106,318
EARNINGS PER WEIGHTED-AVERAGE COMMON SHARE OUTSTANDING		
Income from continuing operations attributable to common shareholders – basic	$ 2.90	$ 3.02
Net income attributable to common shareholders – basic	3.00	3.24
Income from continuing operations attributable to common shareholders – diluted	2.88	3.01
Net income attributable to common shareholders – diluted	2.98	3.22
DIVIDENDS DECLARED PER SHARE	$ 1.575	$ 1.575
AMOUNTS ATTRIBUTABLE TO COMMON SHAREHOLDERS:		
Income from continuing operations, net of tax	$ 316,001	$ 319,533
Discontinued operations, net of tax	10,908	23,170
Net income attributable to common shareholders	$ 326,909	$ 342,703

See Notes to Pinnacle West's Condensed Consolidated Financial Statements.

PINNACLE WEST CAPITAL CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(unaudited)
(dollars in thousands)

	September 30, 2011	December 31, 2010
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 564,712	$ 110,188
Customer and other receivables	365,868	324,207
Accrued unbilled revenues	184,169	103,292
Allowance for doubtful accounts	(4,126)	(7,981)
Materials and supplies (at average cost)	203,118	181,414
Fossil fuel (at average cost)	25,403	21,575
Deferred income taxes	107,732	124,897
Income tax receivable (Note 6)	--	2,483
Assets from risk management activities (Note 8)	27,713	73,788
Deferred fuel and purchased power regulatory asset (Note 3)	31,611	--
Other regulatory assets (Note 3)	55,852	62,286
Other current assets	29,183	28,362
Total current assets	1,591,235	1,024,511
INVESTMENTS AND OTHER ASSETS		
Assets from risk management activities (Note 8)	32,316	39,032
Nuclear decommissioning trust (Note 17)	488,551	469,886
Other assets	63,731	116,216
Total investments and other assets	584,598	625,134
PROPERTY, PLANT AND EQUIPMENT		
Plant in service and held for future use	13,423,406	13,201,960
Accumulated depreciation and amortization	(4,684,760)	(4,514,204)
Net	8,738,646	8,687,756
Construction work in progress	618,728	459,361
Palo Verde sale leaseback, net of accumulated depreciation (Note 7)	133,832	137,956
Intangible assets, net of accumulated amortization	176,401	184,952
Nuclear fuel, net of accumulated amortization	134,232	108,794
Total property, plant and equipment	9,801,839	9,578,819
DEFERRED DEBITS		
Regulatory assets (Note 3)	977,975	986,370
Income tax receivable (Note 6)	68,201	65,103
Other	126,515	113,061
Total deferred debits	1,172,691	1,164,534
TOTAL ASSETS	$ 13,150,363	$ 12,392,998

See Notes to Pinnacle West's Condensed Consolidated Financial Statements.

PINNACLE WEST CAPITAL CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(unaudited)
(dollars in thousands)

	September 30, 2011	December 31, 2010
LIABILITIES AND EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 281,647	$ 236,354
Accrued taxes (Note 6)	191,507	104,711
Accrued interest	56,174	54,831
Short-term borrowings	--	16,600
Current maturities of long-term debt	876,363	631,879
Customer deposits	71,772	68,322
Liabilities from risk management activities (Note 8)	60,667	58,976
Deferred fuel and purchased power regulatory liability (Note 3)	--	58,442
Other regulatory liabilities (Note 3)	94,374	80,526
Other current liabilities	150,764	139,063
Total current liabilities	1,783,268	1,449,704
LONG-TERM DEBT LESS CURRENT MATURITIES		
Long-term debt less current maturities	2,963,457	2,948,991
Palo Verde sale leaseback lessor notes less current maturities (Note 7)	83,130	96,803
Total long-term debt less current maturities	3,046,587	3,045,794
DEFERRED CREDITS AND OTHER		
Deferred income taxes	1,955,458	1,863,861
Regulatory liabilities (Note 3)	689,120	614,063
Liability for asset retirements (Note 15)	258,332	328,571
Liabilities for pension and other postretirement benefits (Note 4)	877,485	813,121
Liabilities from risk management activities (Note 8)	58,745	65,390
Customer advances	112,730	121,645
Coal mine reclamation	117,779	117,243
Unrecognized tax benefits (Note 6)	76,936	66,349
Other	170,928	132,031
Total deferred credits and other	4,317,513	4,122,274
COMMITMENTS AND CONTINGENCIES (SEE NOTES)		
EQUITY (Note 9)		
Common stock, no par value	2,441,621	2,421,372
Treasury stock	(5,232)	(2,239)
Total common stock	2,436,389	2,419,133
Retained earnings	1,579,240	1,423,961
Accumulated other comprehensive loss:		
Pension and other postretirement benefits	(56,582)	(59,420)
Derivative instruments	(64,962)	(100,347)
Total accumulated other comprehensive loss	(121,544)	(159,767)
Total shareholders' equity	3,894,085	3,683,327
Noncontrolling interests (Note 7)	108,910	91,899
Total equity	4,002,995	3,775,226
TOTAL LIABILITIES AND EQUITY	$ 13,150,363	$ 12,392,998

See Notes to Pinnacle West's Condensed Consolidated Financial Statements.

PINNACLE WEST CAPITAL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)
(dollars in thousands)

	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 346,950	$ 357,708
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on sale of district cooling business	--	(41,973)
Gain on sale of energy-related products and services business	(10,404)	--
Depreciation and amortization including nuclear fuel	370,107	350,762
Deferred fuel and purchased power	30,965	50,020
Deferred fuel and purchased power amortization	(121,018)	(95,926)
Allowance for equity funds used during construction	(18,697)	(16,417)
Real estate impairment charges	--	16,731
Gain on real estate debt restructuring	--	(14,403)
Deferred income taxes	131,582	281,486
Change in mark-to-market valuations	1,861	3,716
Changes in current assets and liabilities:		
Customer and other receivables	(47,410)	(103,973)
Accrued unbilled revenues	(80,877)	(69,035)
Materials, supplies and fossil fuel	(25,532)	19,011
Other current assets	(1,581)	(6,027)
Accounts payable	29,340	36,687
Accrued taxes and income tax receivable-net	89,534	56,851
Other current liabilities	30,300	6,738
Change in margin and collateral accounts – assets	33,591	(4,336)
Change in margin and collateral accounts – liabilities	85,785	(143,725)
Change in unrecognized tax benefits	12,123	(72,649)
Change in other long-term assets	(10,678)	(59,382)
Change in other long-term liabilities	74,565	17,636
Net cash flow provided by operating activities	920,506	569,500
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(643,261)	(552,707)
Contributions in aid of construction	36,351	25,258
Allowance for borrowed funds used during construction	(14,371)	(12,553)
Proceeds from sale of district cooling business	--	100,300
Proceeds from sale of energy-related products and services business	45,111	--
Proceeds from nuclear decommissioning trust sales	405,637	424,255
Investment in nuclear decommissioning trust	(417,957)	(442,567)
Proceeds from sale of commercial real estate investments	1,100	71,174
Proceeds from sale of life insurance policies	55,444	--
Other	(2,346)	9,621
Net cash flow used for investing activities	(534,292)	(377,219)
CASH FLOWS FROM FINANCING ACTIVITIES		
Issuance of long-term debt	470,353	--
Repayment of long-term debt	(228,457)	(84,529)
Short-term borrowings and payments – net	(16,600)	(153,715)
Dividends paid on common stock	(166,197)	(161,722)
Common stock equity issuance	14,953	255,156
Distributions to noncontrolling interests	(2,610)	(3,286)
Other	(3,132)	6,352
Net cash flow provided by (used for) financing activities	68,310	(141,744)
NET INCREASE IN CASH AND CASH EQUIVALENTS	454,524	50,537
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	110,188	145,378
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 564,712	$ 195,915
Supplemental disclosure of cash flow information		
Cash paid during the period for:		
Income taxes, net of (refunds)	$ 5,676	$ (22,165)
Interest, net of amounts capitalized	$ 163,250	$ 167,576

See Notes to Pinnacle West's Condensed Consolidated Financial Statements.

1. Consolidation and Nature of Operations

The unaudited condensed consolidated financial statements include the accounts of Pinnacle West and our subsidiaries: APS, SunCor Development Company ("SunCor"), APS Energy Services Company, Inc. ("APSES"), and El Dorado Investment Company ("El Dorado"). See Note 13 for discussion of discontinued operations of APSES. Intercompany accounts and transactions between the consolidated companies have been eliminated. The unaudited condensed consolidated financial statements for APS include the accounts of APS and the Palo Verde Nuclear Generating Station ("Palo Verde") sale leaseback variable interest entities ("VIEs") (see Note 7 for further discussion). Our accounting records are maintained in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Weather conditions cause significant seasonal fluctuations in our revenues; therefore, results for interim periods do not necessarily represent results expected for the year.

In preparing the condensed consolidated financial statements, we have evaluated the events that have occurred after September 30, 2011 through the date the financial statements were issued.

Our condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments except as otherwise disclosed in the notes) that we believe are necessary for the fair presentation of our financial position, results of operations and cash flows for the periods presented. These condensed consolidated financial statements and notes have been prepared consistently with the 2010 Form 10-K with the exception of the reclassification of certain prior year amounts on our Condensed Consolidated Statements of Income, Condensed Consolidated Balance Sheets and Condensed Consolidated Statements of Cash Flows in accordance with accounting requirements for reporting discontinued operations (see Note 13) and the impacts related to the reclassification of regulatory assets and liabilities for the current portion (see Note 3).

The following tables show the impact of the reclassifications to prior year (previously reported) amounts (dollars in thousands):

Statement of Income for the Three Months Ended September 30, 2010	As previously reported	Reclassifications for discontinued operations	Amount reported after reclassification for discontinued operations
Operating Revenues			
Other revenues	$ 22,874	$ (22,375)	$ 499
Operating Expenses			
Operations and maintenance	221,469	(1,811)	219,658
Depreciation and amortization	104,194	(17)	104,177
Other expenses	18,365	(17,196)	1,169
Other			
Other income	4,348	(87)	4,261
Other expense	(3,855)	(39)	(3,894)
Interest Expense			
Interest charges	60,491	(72)	60,419
Income Taxes	123,486	(1,139)	122,347
Income From Continuing Operations	231,828	(2,266)	229,562
Income From Discontinued Operations	7,211	2,266	9,477

Statement of Income for the Nine Months Ended September 30, 2010	As previously reported	Reclassifications for discontinued operations	Amount reported after reclassification for discontinued operations
Operating Revenues			
Other revenues	$ 52,982	$ (48,267)	$ 4,715
Operating Expenses			
Operations and maintenance	644,415	(4,835)	639,580
Depreciation and amortization	307,864	(58)	307,806
Taxes other than income taxes	100,936	(3)	100,933
Other expenses	41,009	(37,437)	3,572
Other			
Other income	3,828	23	3,851
Other expense	(8,650)	(118)	(8,768)
Interest Expense			
Allowance for borrowed funds used during construction	(12,314)	60	(12,254)
Income Taxes	168,143	(2,261)	165,882
Income From Continuing Operations	338,395	(3,828)	334,567
Income From Discontinued Operations	19,313	3,828	23,141

Balance Sheets - December 31, 2010	As previously reported	Reclassifications for regulatory assets and liabilities	Amount reported after reclassification for regulatory assets and liabilities
Current Assets – Deferred income taxes	$ 94,602	$ 30,295	$ 124,897
Current Assets – Other regulatory assets	--	62,286	62,286
Deferred Debits – Regulatory assets	1,048,656	(62,286)	986,370
Current Liabilities – Deferred fuel and purchased power regulatory liability	--	58,442	58,442
Current Liabilities – Other regulatory liabilities	--	80,526	80,526
Deferred Credits and Other – Deferred income taxes	1,833,566	30,295	1,863,861
Deferred Credits and Other – Deferred fuel and purchased power regulatory liability	58,442	(58,442)	--
Deferred Credits and Other – Regulatory liabilities	694,589	(80,526)	614,063

Statement of Cash Flows for the Nine Months Ended September 30, 2010	As previously reported	Reclassifications for regulatory assets and liabilities and to conform to current year *presentation*	Amount reported after reclassification for regulatory assets and liabilities and to conform to current year *presentation*
Cash Flows from Operating Activities			
Other current assets	$ (13,236)	$ 7,209	$ (6,027)
Other current liabilities	10,989	(4,251)	6,738
Expenditures for real estate investments	(514)	514	--
Gains and other changes in real estate assets	1,811	(1,811)	--
Change in other regulatory liabilities	40,121	(40,121)	--
Change in other long-term assets	(51,659)	(7,723)	(59,382)
Change in other long-term liabilities	(28,547)	46,183	17,636

2. Long-Term Debt and Liquidity Matters

Pinnacle West and APS maintain committed revolving credit facilities in order to enhance liquidity and provide credit support for their commercial paper programs.

Pinnacle West

On February 23, 2011, Pinnacle West entered into a $175 million term-loan facility that matures February 20, 2015. Pinnacle West used the proceeds of the loan to repay its 5.91% $175 million Senior Notes. Interest rates are based on Pinnacle West's senior unsecured debt credit ratings or, if unavailable, its long-term issuer ratings. Through September 30, 2011, Pinnacle West has repaid $40 million of the $175 million term loan facility.

At September 30, 2011, Pinnacle West's $200 million credit facility, which matures in February 2013, was available for bank borrowings, support of its $200 million commercial paper program, or for issuances of letters of credit. At September 30, 2011, Pinnacle West had no outstanding borrowings or letters of credit under this credit facility and no outstanding commercial paper borrowings. Pinnacle West has the option to increase the amount of the facility up to a maximum of $300 million upon the satisfaction of certain conditions and with the consent of the lenders.

APS

On February 14, 2011, APS refinanced its $489 million revolving credit facility that would have matured in September 2011, with a new $500 million facility. The new revolving credit facility terminates in February 2015. APS may increase the amount of the facility up to a maximum of $700 million upon the satisfaction of certain conditions and with the consent of the lenders. APS uses the facility for general corporate purposes, commercial paper program support and for the issuance of letters of credit, as necessary from time to time. Interest rates are based on APS's senior unsecured debt credit ratings.

On August 25, 2011, APS issued $300 million of 5.05% unsecured senior notes that mature on September 1, 2041. The net proceeds from the sale of the notes were used along with cash on hand to repay at maturity APS's $400 million aggregate principal amount of 6.375% senior notes due October 15, 2011.

On September 7, 2011, APS entered into a new letter of credit agreement supporting its approximately $27 million aggregate principal amount of Coconino County, Arizona Pollution Control Corporation Pollution Control Revenue Refunding Bonds (Arizona Public Service Company Navajo Project), 2009 Series B. The agreement expires September 22, 2016.

At September 30, 2011, APS had two credit facilities totaling $1 billion, including the $500 million credit facility described above and a $500 million facility that matures in February 2013. These facilities are available to support its $250 million commercial paper program, for bank borrowings or for issuances of letters of credit. At September 30, 2011, APS had no borrowings outstanding under any of its credit facilities and no outstanding commercial paper. A $20 million letter of credit was outstanding under APS's 2011 $500 million credit facility described above.

See "Financial Assurances" in Note 10 for discussion of APS's other letters of credit.

Debt Fair Value

Our long-term debt fair value estimates are based on quoted market prices for the same or similar issues. Certain of our debt instruments contain third-party credit enhancements and, in accordance with GAAP, we do not consider the effect of these credit enhancements when determining fair value. The following table represents the estimated fair value of our long-term debt, including current maturities (dollars in millions):

	As of September 30, 2011		As of December 31, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Pinnacle West	$ 135	$ 135	$ 175	$ 176
APS	3,788	4,219	3,503	3,737
Total	$ 3,923	$ 4,354	$ 3,678	$ 3,913

Debt Provisions

An existing ACC order requires APS to maintain a common equity ratio of at least 40%. As defined in the ACC order, the common equity ratio is total shareholder equity divided by the sum of total shareholder equity and long-term debt, including current maturities of long-term debt. At September 30, 2011, APS was in compliance with this common equity ratio requirement. Its total shareholder equity was approximately $4.0 billion, and total capitalization was approximately $7.7 billion. APS would be prohibited from paying dividends if the payment would reduce its total shareholder equity below approximately $3.1 billion, assuming APS's total capitalization remains the same. Since APS was in compliance with this common equity ratio requirement, this restriction does not materially affect Pinnacle West's ability to meet its ongoing capital requirements.

3. Regulatory Matters

Retail Rate Case Filing with the Arizona Corporation Commission

On June 1, 2011, APS filed an application with the ACC for a net retail base rate increase of $95.5 million. The Company requested that the increase become effective July 1, 2012. The request would increase the average retail customer bill approximately 6.6%. The filing is based on a test year ended December 31, 2010, adjusted as described below. APS's filing was deemed sufficient by the ACC staff and a hearing has been scheduled to begin January 19, 2012.

The key financial provisions of the request included:

- an increase in non-fuel base rates of $194.1 million, before the reclassification into base rates of $44.9 million of revenues related to solar generation projects collected through the Company's renewable energy surcharge (which will increase base rates) and $143.5 million of lower fuel and purchased power costs currently addressed through the Power Supply Adjustor (the "PSA") (which will decrease base rates);

- a rate base of $5.7 billion, which approximates the ACC-jurisdictional portion of the book value of utility assets, net of accumulated depreciation and other credits, as of December 31, 2010, subject to certain adjustments, including plant additions under construction at the end of the test year that are currently in service or expected to be placed into service before the proposed rates are requested to become effective;

- the following proposed capital structure and costs of capital:

	Capital Structure	Cost of Capital
Long-term debt	46.1%	6.38%
Common stock equity	53.9%	11.00%
Weighted-average cost of capital		8.87%

- a base rate for fuel and purchased power costs ("Base Fuel Rate") of $0.03242 per kilowatt-hour ("kWh") based on estimated 2012 prices (a decrease from the current Base Fuel Rate of $0.03757 per kWh).

The Company proposed that its PSA be modified to allow full pass-through of all fuel and purchased power costs, instead of the current 90/10 sharing provision. In addition, APS proposed two new recovery mechanisms that would adjust electricity rates annually between changes in retail base rates. The Efficiency and Infrastructure Account, a decoupling mechanism, would address recovery of the Company's fixed costs after reflecting implementation of ACC-mandated energy efficiency standards and renewable distributed generation. The Environmental and Reliability Account, a generation infrastructure adjustment mechanism, would allow recovery of the costs associated with generation investments related to new generation additions, generation efficiency projects and environmental compliance requirements.

2008 General Retail Rate Case Impacts

On December 30, 2009, the ACC issued an order approving a settlement agreement entered into by APS and twenty-one other parties in APS's prior general retail rate case, which was originally filed in March 2008. The settlement agreement included a net retail rate increase of $207.5 million, which represented a base rate increase of $344.7 million less a reclassification of $137.2 million of fuel and purchased power revenues from the then-existing PSA to base rates. The new rates were effective January 1, 2010. The settlement agreement also contained on-going requirements, commitments and authorizations, including the following:

- Revenue accounting treatment for line extension payments received for new or upgraded service from January 1, 2010 through year end 2012 (or until new rates are established in APS's next general rate case, if that is before the end of 2012);

- An authorized return on common equity of 11%;

- A capital structure comprised of 46.2% debt and 53.8% common equity;

- A commitment from APS to reduce average annual operational expenses by at least $30 million from 2010 through 2014 (APS filed a notification with the ACC on April 29, 2011, demonstrating its compliance with this provision in 2010);

- Authorization and requirements of equity infusions into APS of at least $700 million during the period beginning June 1, 2009 through December 31, 2014 ($253 million of which was infused into APS from proceeds of a Pinnacle West equity issuance in the second quarter of 2010); and

- Various modifications to the existing energy efficiency, demand-side management and renewable energy programs that require APS to, among other things, expand its conservation and demand-side management programs and its use of renewable energy, as well as allow for concurrent recovery of renewable energy expenses and provide for more concurrent recovery of demand-side management costs and incentives.

Cost Recovery Mechanisms

APS has received regulatory decisions that allow for more timely recovery of certain costs through the following recovery mechanisms.

Renewable Energy Standard. In 2006, the ACC approved the Arizona Renewable Energy Standard and Tariff ("RES"). Under the RES, electric utilities that are regulated by the ACC must supply an increasing percentage of their retail electric energy sales from eligible renewable resources, including solar, wind, biomass, biogas and geothermal technologies. In order to achieve these requirements, the ACC allows APS to include a RES surcharge as part of customer bills to recover the approved amounts for use on renewable energy projects. Each year APS is required to file a five-year implementation plan with the ACC and seek approval for funding the upcoming year's RES budget.

During 2009, APS filed its annual RES implementation plan, covering the 2010-2014 timeframe and requesting 2010 RES funding approval. The plan provided for the acquisition of renewable generation in compliance with requirements through 2014, and requested RES funding of $87 million for 2010, which was later approved by the ACC. APS also sought various other determinations in its plan, including approval of the AZ Sun Program and the Community Power Project in Flagstaff, Arizona described below.

On March 3, 2010, the ACC approved the AZ Sun Program, which contemplates the addition of 100 megawatts ("MW") of APS-owned solar resources through 2014. Through this program, APS plans to invest up to $500 million in solar photovoltaic projects across Arizona, which APS will acquire through competitive procurement processes. The costs associated with the first 50 MW under this program will be recovered initially through the RES until such time as the costs are recovered in base rates or other mechanisms. The costs of the second 50 MW will be recovered through a mechanism to be determined in APS's current retail rate case, although APS seeks to recover 19 MW of this second tranche in its 2012 RES implementation plan as discussed below.

On April 1, 2010, the ACC approved the Community Power Project, a pilot program in which APS will own, operate and receive energy from approximately 1.5 MW of solar panels on the rooftops of up to 200 residential and business customers located within a certain test area in Flagstaff, Arizona. The capital carrying costs of the program will be recovered through the RES until such time as these costs are recovered in base rates.

On July 1, 2010, APS filed its annual RES implementation plan, covering the 2011-2015 timeframe and requesting 2011 RES funding of $96 million. The 2011 Plan addressed enhancements to the residential distributed energy incentive program based on high customer participation, among other things. On October 13, 2010, APS filed an adjusted RES implementation plan to reflect the following items, among others: 1) increased clarity relating to customer project in-service dates and related budget revisions; 2) AZ Sun Program updates; and 3) the addition of 10 MW of biomass capacity. On December 10, 2010, the ACC approved the 2011 Plan and associated funding request. On February 11, 2011, the ACC amended its original decision that approved the 2011 Plan as follows: the ACC (a) reversed its approval of a feed-in tariff program; (b) restricted APS's ownership of facilities to only economically challenged, rural schools and only after a school has received a bid from a third-party solar installer; (c) approved the Rapid Reservation program; and (d) maintained the original approved budget with some timing modifications.

On July 1, 2011, APS filed its annual RES implementation plan, covering the 2012-2016 timeframe and requesting 2012 RES funding of $129 million to $152 million. The range in the funding request arises from APS offering several options for third-party initiatives. The options involve obtaining 150 MW from third-parties entirely through power purchase agreements ("PPAs") or through a mix of PPAs and non-residential distributed energy programs. APS also proposed (i) an additional 100 MW of APS-owned AZ Sun projects; (ii) permission to recover costs for a 19 MW AZ Sun project now instead of waiting for a recovery mechanism in APS's current retail rate case; and (iii) an additional 25 MW of APS-owned systems on school and government facilities. On October 26, 2011, the ACC staff issued a report recommending an RES budget of $131.7 million, including the addition of 100 MW of APS-owned AZ Sun projects, permission to recover costs for a 19 MW AZ Sun project through the 2012 RES, and an additional 15 MW of APS-owned systems on school and government facilities. APS expects a decision from the ACC by year end.

Demand-Side Management Adjustor Charge ("DSMAC"). The settlement agreement related to the 2008 retail rate case requires APS to submit an annual Energy Efficiency Implementation Plan for review by and approval of the ACC. On July 15, 2009, APS filed its initial Energy Efficiency Implementation Plan, requesting approval by the ACC of programs and program elements for which APS had estimated a budget in the amount of $50 million for 2010. APS received ACC approval of all of its proposed programs and implemented the new DSMAC on March 1, 2010. A surcharge was added to customer bills in order to recover these estimated amounts for use on certain demand-side management programs. The surcharge allows for the recovery of energy efficiency expenses and any earned incentives.

The ACC approved recovery of all 2009 program costs plus incentives. The change from program cost recovery on a historical basis to recovery on a concurrent basis, as authorized in the settlement agreement, resulted in this one-time need to address two years (2009 and 2010) of cost recovery. As requested by APS, 2009 program cost recovery is to be amortized over a three-year period.

On June 1, 2010, APS filed its 2011 Energy Efficiency Implementation Plan. In order to meet the energy efficiency goal for 2011 established by the settlement agreement of annual energy savings of 1.25%, expressed as a percent of total energy resources to meet retail load, APS proposed a total budget for 2011 of $79 million. On February 17, 2011, a total budget for 2011 of $80 million was approved and, when added to the amortization of 2009 program costs discussed above less the $10 million already being recovered in general rates, the DSMAC would recover approximately $75 million over a twelve-month period beginning March 1, 2011.

On June 1, 2011, APS filed its 2012 Energy Efficiency Implementation Plan to meet the energy efficiency requirements of the ACC's Energy Efficiency Rules, which became effective January 1, 2011. The 2012 requirement under such rules is for energy efficiency savings of 1.75% of APS retail sales for the prior year. This energy savings requirement is slightly higher than the goal established by the settlement agreement (1.5% of total energy resources). APS proposed a budget for 2012 of $90 million. When added to the third and final year of the amortization of 2009 program costs discussed above and less the $10 million already being recovered in general rates, the proposed 2012 DSMAC would recover approximately $85 million over a twelve month period beginning March 1, 2012. APS expects a decision from the ACC by year end.

PSA Mechanism and Balance. The PSA provides for the adjustment of retail rates to reflect variations in retail fuel and purchased power costs.

The following table shows the changes in the deferred fuel and purchased power regulatory asset (liability) for 2011 and 2010 (dollars in millions):

	Nine Months Ended September 30,	
	2011	2010
Beginning balance	$ (58)	$ (87)
Deferred fuel and purchased power costs-current period	(31)	(50)
Amounts refunded through revenues	121	96
Ending balance	$ 32	$ (41)

The PSA rate for the PSA year beginning February 1, 2011 is ($0.0057) per kWh as compared to ($0.0045) per kWh for the prior year. Any uncollected (overcollected) deferrals during the 2011 PSA year will be included in the calculation of the PSA rate for the PSA year beginning February 1, 2012.

Transmission Rates and Transmission Cost Adjustor. In July 2008, the United States Federal Energy Regulatory Commission ("FERC") approved an Open Access Transmission Tariff for APS to move from fixed rates to a formula rate-setting methodology in order to more accurately reflect and recover the costs that APS incurs in providing transmission services. A large portion of the rate represents charges for transmission services to serve APS's retail customers ("Retail Transmission Charges"). In order to recover the Retail Transmission Charges, APS must file an application with, and obtain approval from, the ACC to reflect changes in Retail Transmission Charges through the transmission cost adjustor ("TCA").

The formula rate is updated each year effective June 1 on the basis of APS's actual cost of service, as disclosed in APS's FERC Form 1 report for the previous fiscal year. Items to be updated include actual capital expenditures made as compared with previous projections, transmission revenue credits and other items. The resolution of proposed adjustments can result in significant volatility in the revenues to be collected. APS reviews the proposed formula rate filing amounts with the ACC staff. Any items or adjustments which are not agreed to by APS and the ACC staff can remain in dispute until settled or litigated at FERC. Settlement or litigated resolution of disputed issues could require an extended period of time and could have a significant effect on the Retail Transmission

Charge because any adjustment, though applied prospectively, may be calculated to account for previously over-collected amounts.

Effective June 1, 2011, APS's annual wholesale transmission rates for all users of its transmission system increased by approximately $44 million for the twelve-month period beginning June 1, 2011 in accordance with the FERC-approved formula as a result of higher costs and lower revenues reflected in the formula. Approximately $38 million of this revenue increase relates to Retail Transmission Charges. The ACC approved the related increase of APS's TCA rate on June 21, 2011 and it became effective on July 1, 2011.

Regulatory Assets and Liabilities

As discussed in Note 1, as of September 30, 2011, the Company revised its presentation of regulatory assets and liabilities to separately reflect current and non-current amounts on the Condensed Consolidated Balance Sheets. This presentation is reflected in the tables below.

The detail of regulatory assets is as follows (dollars in millions):

	September 30, 2011		December 31, 2010	
	Current	Non-Current	Current	Non-Current
Pension and other postretirement benefits	$ --	$ 663	$ --	$ 669
Deferred income taxes	3	82	3	69
Deferred fuel and purchased power – mark-to-market (Note 8)	35	27	42	35
Transmission vegetation management	9	34	--	46
Coal reclamation	2	35	2	36
Palo Verde VIE (Note 7)	--	34	--	33
Deferred compensation	--	34	--	32
Deferred fuel and purchased power (a)	32	--	--	--
Tax expense of Medicare subsidy	2	18	2	21
Loss on reacquired debt	1	19	1	21
Pension and other post-retirement benefits deferral	--	9	--	--
Demand side management (a)	3	2	12	6
Other	--	21	--	18
Total regulatory assets (b)	$ 87	$ 978	$ 62	$ 986

(a) See Cost Recovery Mechanisms discussion above.

(b) There are no regulatory assets for which the ACC has allowed recovery of costs but not allowed a return by exclusion from rate base. FERC rates are set using a formula rate as described in "Transmission Rates and Transmission Cost Adjustor."

The detail of regulatory liabilities is as follows (dollars in millions):

	September 30, 2011		December 31, 2010	
	Current	Non-Current	Current	Non-Current
Removal costs (a)	$ 21	$ 355	$ 22	$ 357
Asset retirement obligations (Note 15)	--	202	--	184
Renewable energy standard (b)	58	--	50	--
Income taxes – change in rates	--	50	--	--
Spent nuclear fuel	5	43	4	41
Deferred gains on utility property	2	15	2	16
Income taxes- deferred investment tax credit	--	9	--	1
Deferred fuel and purchased power (b)(c)	--	--	58	--
Other	8	15	3	15
Total regulatory liabilities	$ 94	$ 689	$ 139	$ 614

(a) In accordance with regulatory accounting guidance, APS accrues for removal costs for its regulated assets, even if there is no legal obligation for removal.
(b) See Cost Recovery Mechanisms discussion above.
(c) Subject to a carrying charge.

4. Retirement Plans and Other Benefits

Pinnacle West sponsors a qualified defined benefit and account balance pension plan, a non-qualified supplemental excess benefit retirement plan, and other postretirement benefit plans for the employees of Pinnacle West and our subsidiaries. Pinnacle West uses a December 31 measurement date for its pension and other postretirement benefit plans. The market-related value of our plan assets is their fair value at the measurement date.

Certain pension and other postretirement benefit costs in excess of amounts recovered in electric retail rates are deferred as a regulatory asset for future recovery, pursuant to an ACC regulatory order. The following table provides details of the plans' net periodic benefit costs and the portion of these costs charged to expense (including administrative costs and excluding amounts capitalized as overhead construction, billed to electric plant participants or charged to the regulatory asset) (dollars in millions):

	Pension Benefits				Other Benefits			
	Three Months Ended September 30,		Nine Months Ended September 30,		Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010	2011	2010	2011	2010
Service cost - benefits earned during the period	$ 14	$ 14	$ 43	$ 42	$ 5	$ 4	$ 17	$ 14
Interest cost on benefit obligation	31	31	94	92	12	11	35	32
Expected return on plan assets	(33)	(31)	(100)	(93)	(10)	(9)	(31)	(29)
Amortization of:								
Prior service cost	--	--	1	1	--	--	--	--
Net actuarial loss	7	5	19	15	4	2	11	7
Net periodic benefit cost	$ 19	$ 19	$ 57	$ 57	$ 11	$ 8	$ 32	$ 24
Portion of cost charged to expense	$ 7	$ 10	$ 22	$ 29	$ 4	$ 4	$ 12	$ 12

Contributions

The required minimum contribution to our pension plan is zero in 2011 and approximately $68 million in 2012. The contributions to our other postretirement benefit plans for 2011 and 2012 are expected to be approximately $20 million each year.

5. Business Segments

Pinnacle West's reportable business segment is our regulated electricity segment, which consists of traditional regulated retail and wholesale electricity businesses (primarily retail and wholesale sales supplied to traditional cost-based rate regulation ("Native Load") customers) and related activities and includes electricity generation, transmission and distribution.

Financial data for the three and nine months ended September 30, 2011 and 2010 and at September 30, 2011 and December 31, 2010 is provided as follows (dollars in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Operating revenues:				
Regulated electricity segment	$ 1,124	$ 1,116	$ 2,571	$ 2,527
All other	1	1	2	5
Total	$ 1,125	$ 1,117	$ 2,573	$ 2,532
Net income attributable to common shareholders:				
Regulated electricity segment	$ 246	$ 225	$ 318	$ 320
All other (a)	9	9	9	23
Total	$ 255	$ 234	$ 327	$ 343

	As of September 30, 2011	As of December 31, 2010
Assets:		
Regulated electricity segment	$ 13,112	$ 12,285
All other (a)	38	108
Total	$ 13,150	$ 12,393

(a) All other activities relate to APSES, SunCor, Pinnacle West and El Dorado.

6. Income Taxes

The $68 million income tax receivable on the Condensed Consolidated Balance Sheets represents the anticipated refunds related to an APS tax accounting method change approved by the Internal Revenue Service ("IRS") in the third quarter of 2009. This amount is classified as long-term, as cash refunds are not expected to be received in the next twelve months.

On February 17, 2011, Arizona enacted legislation (H.B. 2001) that included a four year phase-in of corporate income tax rate reductions beginning in 2014. As a result of these tax rate reductions, Pinnacle West has revised the tax rate applicable to reversing temporary items in Arizona. In accordance with accounting for regulated companies, the benefit of this rate reduction is substantially offset by a regulatory liability. In the first quarter of 2011, Pinnacle West increased regulatory liabilities by a total of $53 million, with a corresponding decrease in accumulated deferred income tax liabilities to reflect the impact of this change in tax law.

As of the balance sheet date, the tax year ended December 31, 2008 and all subsequent tax years remain subject to examination by the IRS. With few exceptions, we are no longer subject to state income tax examinations by tax authorities for years before 2006. We do not anticipate that there will be any significant increases or decreases in our unrecognized tax benefits within the next twelve months.

7. Palo Verde Sale Leaseback Variable Interest Entities

In 1986, APS entered into agreements with three separate VIE lessor trusts in order to sell and lease back interests in Palo Verde Unit 2 and related common facilities. The VIE lessor trusts are single-asset leasing entities. APS will pay approximately $49 million per year for the years 2011 to 2015 related to these leases. The leases do not contain fixed price purchase options or residual value guarantees. However, the lease agreements include fixed rate renewal periods which may have a significant impact on the VIEs' economic performance. We have concluded that these fixed rate renewal periods may give APS the ability to utilize the asset for a significant portion of the asset's economic life, and therefore provide APS with the power to direct activities of the VIEs that most significantly impact the VIEs' economic performance. In addition to the fixed rate renewal periods, our primary beneficiary analysis also considered that APS is the operating agent for Palo Verde, has fair value purchase options, and is obligated to decommission the leased assets.

For the reasons discussed above, APS consolidates these VIEs. Assets of the VIEs are restricted and may only be used to settle the VIEs' debt obligations and for payment to the noncontrolling interest holders. Other than the VIEs' assets reported on our consolidated financial statements, the creditors of the VIEs have no other recourse to the assets of APS or Pinnacle West, except in certain circumstances such as a default by APS under the lease. As a result of consolidation we eliminate rent expense and recognize depreciation and interest expense, resulting in an increase in net income for the three and nine months ended September 30, 2011 of $7 million and of $20 million respectively, entirely attributable to the noncontrolling interests. Income attributable to Pinnacle West shareholders remains the same. Consolidation of these VIEs also results in changes to our Condensed Consolidated Statements of Cash Flows, but does not impact net cash flows.

Our Condensed Consolidated Balance Sheets at September 30, 2011 and December 31, 2010 include the following amounts relating to the VIEs (in millions):

	September 30, 2011	December 31, 2010
Property plant and equipment, net of accumulated depreciation	$ 134	$ 138
Current maturities of long-term debt	30	29
Long-term debt less current maturities	83	97
Equity- Noncontrolling interests	109	91

For regulatory ratemaking purposes the agreements are treated as operating leases and, as a result, we have recorded a regulatory asset of $34 million as of September 30, 2011 and $33 million as of December 31, 2010.

APS is exposed to losses relating to these lessor trust VIEs upon the occurrence of certain events that APS does not consider to be reasonably likely to occur. Under certain circumstances (for example, the United States Nuclear Regulatory Commission ("NRC") issuing specified violation orders with respect to Palo Verde or the occurrence of specified nuclear events), APS would be required to make specified payments to the VIEs' noncontrolling equity participants, assume the VIEs' debt, and take title to the leased Unit 2 interests, which, if appropriate, may be required to be written down in value. If such an event had occurred as of September 30, 2011, APS would have been required to pay the noncontrolling equity participants approximately $145 million and assume $113 million of debt. Since APS consolidates the VIEs, the debt APS would be required to assume is already reflected in our Condensed Consolidated Balance Sheets.

8. Derivative Accounting

We are exposed to the impact of market fluctuations in the commodity price and transportation costs of electricity, natural gas, coal, emissions allowances and in interest rates. We manage risks associated with market volatility by utilizing various physical and financial derivative instruments, including futures, forwards, options and swaps. As part of our overall risk management program, we may use derivative instruments to hedge purchases and sales of electricity and fuels. Derivative instruments that meet certain hedge accounting criteria are designated as cash flow hedges and are used to limit our exposure to cash flow variability on forecasted transactions. The changes in market value of such instruments have a high correlation to price changes in the hedged transactions. We also enter into derivative instruments for economic hedging purposes. While we believe the economic hedges mitigate exposure to fluctuations in commodity prices, some of these instruments may not meet the specific hedge accounting requirements and are not designated as accounting hedges. Contracts that have the same terms (quantities and delivery points) and for which power does not flow are netted, which reduces both revenues and fuel and purchased power costs in our Consolidated Statements of Income, but does not impact our financial condition, net income or cash flows.

Our derivative instruments, excluding those qualifying for a scope exception, are recorded on the balance sheet as an asset or liability and are measured at fair value; see Note 14 for a discussion of fair value measurements. Derivative instruments may qualify for the normal purchases and normal sales scope exception if they require physical delivery and the quantities represent those transacted in the normal course of business. Derivative instruments qualifying for the normal purchase and sales scope exception are accounted for under the accrual method of accounting and excluded from our derivative instrument discussion and disclosures below.

Hedge effectiveness is the degree to which the derivative instrument contract and the hedged item are correlated and is measured based on the relative changes in fair value of the derivative instrument contract and the hedged item over time. We assess hedge effectiveness both at inception and on a continuing basis. These assessments exclude the time value of certain options. For accounting hedges that are deemed an effective hedge, the effective portion of the gain or loss on the derivative instrument is reported as a component of accumulated other comprehensive income ("AOCI") and reclassified into earnings in the same period during which the hedged transaction affects earnings. We recognize in current earnings, subject to the PSA, the gains and losses representing hedge ineffectiveness, and the gains and losses on any hedge components which are excluded from our effectiveness assessment. As of September 30, 2011, we hedged the majority of certain exposures to the price variability of commodities for a maximum of 39 months.

For its regulated operations, APS defers for future rate treatment approximately 90% of unrealized gains and losses on certain derivatives pursuant to the PSA mechanism that would otherwise be recognized in income. Realized gains and losses on derivatives are deferred in accordance with the PSA to the extent the amounts are above or below the Base Fuel Rate (see Note 3). Gains and losses from derivatives in the following tables represent the amounts reflected in income before the effect of PSA deferrals.

As of September 30, 2011, we had the following outstanding gross notional volume of derivatives, which represent both purchases and sales (does not reflect net position):

Commodity	Quantity	
Power	11,997	gigawatt hours
Gas	124,151	billion Btu (a)

(a) "Btu" is British thermal units.

Gains and Losses from Derivative Instruments

The following table provides information about gains and losses from derivative instruments in designated cash flow accounting hedging relationships during the three and nine months ended September 30, 2011 and 2010 (dollars in thousands):